CREDIT CARD FAIR FEE ACT OF 2009

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

H.R. 2695

APRIL 28, 2010

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APRIL 28, 2010

CREDIT CARD FAIR FEE ACT OF 2009

WEDNESDAY, APRIL 28, 2010

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 10:15 a.m., in room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Committee) presiding.

Present: Representatives Conyers, Scott, Watt, Jackson Lee, Delahunt, Johnson, Quigley, Chu, Sánchez, Wasserman Schultz, Maffei, Smith, Sensenbrenner, Coble, Goodlatte, Lungren, Forbes, King, Gohmert, Poe, Chaffetz, and Rooney.

Staff present: (Majority) Eric Tamarkin, Counsel; Anant Rant, Counsel; Brandon Johns, Clerk; Reuben Goetzl, Clerk; and Stewart Jeffries, Minority Counsel.

Mr. CONYERS. Good morning. The Committee will come to order.

Today we are examining a bill that we passed out of Committee a couple years ago, and it is a bill—I am going to thank Jim Sensenbrenner for his comments, which I reread before we introduced this new bill, H.R. 2695, that permits merchants to collectively negotiate with banks and payment card networks concerning the rates and terms for access to the—to these interchange fees, credit card costs, hidden charges, that have resulted in us having more than two credit cards for everybody in the United States of America and still counting.

Well, for those that may not be familiar with how easy it is to get a credit card, wait until your son gets to college and he gets one that is active in the mail, and all you have to do is start using it, and explain to dad later as to the necessity that caused him to plunge his parent into near bankruptcy.

And so, what we do in this bill that we are going to examine and listen to our witnesses today is to create a limited antitrust exemption that would allow the merchants—many of them small—to be able to negotiate with the banks and credit cards as to how these rates can be contained.

We cut back on the court business for a lot of reasons—the main reason was because we couldn't get it through anyway, knowing the other body and how they operate. We might not have gotten it through the House.

So we are looking critically at these credit card companies, especially the big ones, the occasional violators of the law. There is a huge class action consumer suit pending in New York regarding the legality of payment card companies' ability to suddenly change fees in the first place. And so this is a—this idea today is an effort to reign in the abuses by the credit card industry.

My colleague, Peter Welch, Vermont, has introduced another measure which would prohibit credit card networks from restricting merchants from steering consumers to particular payment methods. Carolyn Maloney, of New York, has a Credit Cardholder's Bill of Rights that became law last year. The leader in the Senate—has a bill on the same subject.

And so we want to hear from our distinguished witnesses, and we think that we may have gotten a different and a better proposal for us to examine here today.

And I turn now to my friend, Lamar Smith, for his comments.

[The bill, H.R. 2695, follows:]

I

111TH CONGRESS
1ST SESSION

H. R. 2695

To amend the antitrust laws to ensure competitive market-based rates and terms for merchants' access to electronic payment systems.

IN THE HOUSE OF REPRESENTATIVES

JUNE 4, 2009

Mr. CONYERS (for himself and Mr. SHUSTER) introduced the following bill; which was referred to the Committee on the Judiciary

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A BILL

To amend the antitrust laws to ensure competitive market-based rates and terms for merchants' access to electronic payment systems.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Credit Card Fair Fee Act of 2009".

SEC. 2. LIMITED ANTITRUST IMMUNITY FOR THE NEGOTIATION AND DETERMINATION OF RATES AND TERMS FOR ACCESS TO COVERED ELECTRONIC PAYMENT SYSTEMS.

(a) DEFINITIONS.—For purposes of this Act:

(1) "Access agreement" means an agreement giving a merchant permission to access a covered electronic payment system to accept credit cards and/or debit cards from consumers for payment for goods and services as well as to receive payment for such goods and services, conditioned solely upon the merchant complying with the rates and terms specified in the agreement.

(2) "Acquirer" means a financial institution that provides services allowing merchants to access an electronic payment system to accept credit cards and/or debit cards for payment, but does not include independent third party processors that may act as the acquirer's agent in processing general-purpose credit or debit card transactions.

(3) "Antitrust laws" has the meaning given it in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)), except that such term includes section 5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent such section 5 applies to unfair methods of competition as well as any similar State law.

(4) "Credit card" means any general-purpose card or other device issued or approved for use by a financial institution allowing the cardholder to ob-

tain goods or services on credit on terms specified by that financial institution.

(5) ''Covered electronic payment system'' means an electronic payment system that has been used for at least 20 percent of the combined dollar value of U.S. credit card, signature-based debit card, and PIN-based debit card payments processed in the applicable calendar year immediately preceding the year in which the conduct in question occurs.

(6) ''Debit card'' means any general-purpose card or other device issued or approved for use by a financial institution for use in debiting a cardholder's account for the purpose of that cardholder obtaining goods or services, whether authorization is signature-based or PIN-based.

(7) ''Electronic payment system'' means the proprietary services and infrastructure that route information and data to facilitate transaction authorization, clearance, and settlement that merchants must access in order to accept a specific brand of general-purpose credit cards and/or debit cards as payment for goods and services.

(8) ''Financial institution'' has the same meaning as in section 603(t) of the Fair Credit Reporting Act.

(9) "Issuer" means a financial institution that issues credit cards and/or debit cards or approves the use of other devices for use in an electronic payment system, but does not include independent third party processors that may act as the issuer's agent in processing general-purpose credit card or debit card transactions.

(10) "Market power" means the ability profitably to raise prices above those that would be charged in a perfectly competitive market.

(11) "Merchant" means any person who accepts credit cards and/or debit cards in payment for goods or services that they provide.

(12) "Negotiating party" means 1 or more providers of a covered electronic payment system or 1 or more merchants who have access to or who are seeking access to that covered electronic payment system, as the case may be, and who are in the process of negotiating or who have executed a voluntarily negotiated access agreement that is still in effect.

(13) "Person" has the meaning given it in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)).

(14) "Provider" means any person who owns, operates, controls, serves as an issuer for, or serves

as an acquirer for a covered electronic payment system.

(15) "State" has the meaning given it in section 4G(2) of the Clayton Act (15 U.S.C. 15g(2)).

(16) "Terms" means all rules applicable either to providers of a single covered electronic payment system or to merchants, and that are required in order to provide or access that covered electronic payment system for processing credit card and/or debit card transactions.

(17) "Voluntarily negotiated access agreement" means an executed agreement voluntarily negotiated between 1 or more providers of a single covered electronic payment system and 1 or more merchants that sets the rates and terms pursuant to which the 1 or more merchants can access that covered electronic payment system to accept credit cards and/or debit cards from consumers for payment of goods and services, and receive payment for such goods and services.

(b) LIMITED ANTITRUST IMMUNITY FOR NEGOTIATION OF ACCESS RATES AND TERMS TO COVERED ELECTRONIC PAYMENT SYSTEMS.—(1) Except as provided in paragraph (2) and notwithstanding any provision of the antitrust laws, in negotiating access rates and terms any providers of a single covered electronic payment system and any merchants may jointly negotiate and agree upon the rates and terms for access to the covered electronic payment system, including through the use of common agents that represent either providers of a single covered electronic payment system or merchants on a nonexclusive basis. Any providers of a single covered electronic payment system also may jointly determine the proportionate division among themselves of paid access fees.

(2) Notwithstanding any other provision of this Act, the immunity otherwise applicable under paragraph (1) shall not apply to a provider of a single covered electronic payment system, or to a merchant, during any period in which such provider, or such merchant, is engaged in—

(A) any unlawful boycott;

(B) any allocation with a competitor of a geographical area in which an interchange rate will be charged or paid;

(C) any unlawful tying of an interchange rate charged or paid to any other product or service; or

(D) any exchange of information with, or agreement with, a competitor relating to the allocation of revenues lost or redistribution of savings gained from a voluntarily negotiated access agreement if such information or agreement is not reasonably required to carry out the negotiations and agreements described under paragraph (1).

(c) NONDISCRIMINATION.—For any given covered electronic payment system, the rates and terms of a voluntarily negotiated access agreement reached under the authority of this section shall be the same for all merchants, regardless of merchant category or volume of transactions (either in number or dollar value) generated. For any given covered electronic payment system, the rates and terms of a voluntarily negotiated access agreement reached under the authority of this section shall be the same for all providers participating in a negotiation session conducted under the authority of this section, regardless of provider category or volume of transactions (either in number or dollar value) generated.

(d) FACILITATION OF NEGOTIATION.—

(1) SCHEDULE.—Within 1 month following enactment of this Act, the negotiating parties shall file with the Attorney General a schedule for negotiations. If the negotiating parties do not file such a schedule within 1 month from the date of enactment, the Attorney General shall issue such a schedule. In either case, the Attorney General shall make the schedule available to all negotiating parties.

(2) INITIAL DISCLOSURE.—Within 1 month following enactment of this Act, the persons described in this subsection shall make the initial disclosures described in paragraphs (3) and (4) to facilitate negotiations under the limited antitrust immunity provided for by this section.

(3) ISSUERS, ACQUIRERS, AND OWNERS.—Any person who is 1 of the 10 largest issuers for a covered electronic payment system in terms of number of cards issued, any person who is 1 of the 10 largest acquirers for a covered electronic payment system in terms of number of merchants served, and any person who operates or controls a covered electronic payment system shall produce to the Attorney General and to all negotiating parties—

(A) an itemized list of the costs necessary to provide the covered electronic payment system that were incurred by the person during the most recent full calendar year before the initiation of the negotiation; and

(B) any access agreement between that person and 1 or more merchants with regard to that covered electronic payment system.

(4) MERCHANTS.—Any person who is 1 of the 10 largest merchants using the covered electronic

payment system, determined based on dollar amount of transactions made with the covered electronic payment system, shall produce to the Attorney General and to all negotiating parties—

(A) an itemized list of the costs necessary to access an electronic payment system during the most recent full calendar year prior to the initiation of the proceeding; and

(B) any access agreement between that person and 1 or more providers with regard to that covered electronic payment system.

(5) DISAGREEMENT.—Any disagreement regarding whether a person is required to make an initial disclosure under this clause, or the contents of such a disclosure, shall be resolved by the Attorney General.

(6) ATTENDANCE OF THE DEPARTMENT OF JUSTICE.—A representative of the Attorney General shall attend all negotiation sessions conducted under the authority of this section.

(c) TRANSPARENCY OF VOLUNTARILY NEGOTIATED ACCESS AGREEMENTS.—

(1) VOLUNTARILY NEGOTIATED ACCESS AGREEMENTS BETWEEN NEGOTIATING PARTIES.—A voluntarily negotiated access agreement may be executed

at any time between 1 or more providers of a covered electronic payment system and 1 or more merchants.

(2) FILING AGREEMENTS WITH THE ATTORNEY GENERAL.—The negotiating parties shall jointly file with the Attorney General a clear intelligible copy of—

(A) any voluntarily negotiated access agreement that affects any market in the United States or elsewhere;

(B) the various components of the interchange fee;

(C) a description of how access fees that merchants pay are allocated among financial institutions and how they are spent;

(D) whether a variation in fees exists among card types;

(E) any documentation relating to a voluntarily negotiated access agreement evidencing any consideration being given or any marketing or promotional agreements between the negotiating parties;

(F) a comparison of interchange rates in current use in the 10 foreign countries having the highest volume of credit card transactions with the interchange rates charged in the United States under such agreement; and

(G) any amendments to that voluntarily negotiated access agreement or documentation.

(3) TIMING AND AVAILABILITY OF FILINGS.—The negotiating parties to any voluntarily negotiated access agreement executed after the date of enactment of this Act shall jointly file the voluntarily negotiated access agreement, and any documentation or amendments described in paragraph (2), with the Attorney General not later than 30 days after the date of execution of the voluntarily negotiated access agreement or amendment or after the creation of the documentation. The Attorney General shall make publicly available any voluntarily negotiated access agreement, amendment, or accompanying documentation filed under this paragraph.

(f) REPORT TO CONGRESS BY THE ATTORNEY GENERAL.—Within 7 months after the date of enactment of this Act, the Attorney General shall transmit to the House Committee on the Judiciary and the Senate Committee on the Judiciary a report on the negotiations conducted under the authority of this section during the first 6 months after the date of enactment and, if a voluntarily negotiated agreement is reached, whether such access rates and terms will have an adverse effect on competition and how such rates compare with access rates and terms in current use in other countries. Such report shall contain a chronology of the negotiations, an assessment of whether the parties have negotiated in good faith, an assessment of the quality of the data provided by the parties in their initial disclosures, a description of any voluntarily negotiated agreements reached during the negotiations, and any recommendations of the Attorney General concerning how Congress should respond to the conduct of the negotiations.

(g) EFFECT ON PENDING LAWSUITS.—Nothing in this section shall affect liability in any action pending on the date of enactment of this section.

SEC. 3. OPT-OUT.

Nothing in this Act shall limit the ability of acquirers or issuers that are regulated by the National Credit Union Administration or that, together with affiliates, have assets of less than $1,000,000,000, to opt out of negotiations under this Act.

SEC. 4. EFFECTIVE DATE.

This Act shall take effect on the date of the enactment of this Act.

○

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Chairman, in the last Congress this Committee conducted two hearings on the issue of credit card interchange fees. We also reported the Credit Card Fair Fee Act of 2008 by a vote of 19-16 with 10 Democrats and nine Republicans supporting the bill, and eight Democrats and eight Republicans opposing the bill.

While that result may represent a model of bipartisanship, it did little to enhance the prospects of passage on the floor. In fact, the bill did not come up for a vote in the full House in 2008.

A recent Government Accountability Office report said that credit card interchange fees have gone up over time. GAO noted that while merchants would benefit from lowered interchange rates, the effects of those rate decreases could be small.

GAO also predicted that any merchant savings that resulted from interchange reform would likely not be passed on to consumers. GAO noted further that any effort at interchange reform would result in significant compliance cost.

If there is a problem in the setting and amount of credit card fees, this bill may not be the appropriate solution. It grants an antitrust exemption to thousands of banks and hundreds of thousands of merchants, possibly enabling collusion on a gigantic scale.

A group of merchants have brought a series of Federal antitrust suits challenging the way that Visa and MasterCard set these interchange fees. Those cases are pending in court in the eastern district of New York now. While I recognize that the remedy that the merchants are seeking here today could not be granted by a court, I do think the court should decide on the basic question of the credit card liability before we move forward.

Mr. Chairman, I would like to ask unanimous consent to have—to be made part of the record the following letters: one from the American Bankers' Association, a letter from the Electronic Payments Coalition, and a letter from the Credit Union National Association.

[The information referred to follows:]

April 27, 2010

To: Members of the House Committee on the Judiciary

Re: Opposition to Proposals to Regulate Interchange Fees (H.R. 2695)

The House Judiciary Committee has scheduled a hearing on H.R. 2695, the Credit Card Fair Fee Act, this week. If enacted, this bill would seriously disrupt the proper functioning of our nation's electronic payment system to the detriment of consumers, businesses, and the broader economy. Moreover, this legislation would dramatically impact the ability of community banks to competitively provide credit and debit cards to local consumers. The undersigned trade associations strongly urge you to oppose H.R. 2695 or other efforts to regulate interchange rates.

Interchange is a fee that a merchant pays when a consumer uses a credit or debit card to make a purchase. The fee partially reimburses the issuing bank for the significant costs and risks of issuing cards, including infrastructure expenses, fraud risk, and the real risk of non-payment. H.R. 2695 attempts to regulate interchange by allowing retailers to pass their cost of doing business onto the consumer. The bill would require parties to negotiate interchange rates, with negotiations and rates monitored by the Department of Justice. In practice, the bill has the goal of artificially driving down rates through government-endorsed retailer collective activity. If enacted, consumers likely would bear the infrastructure and other costs.

H.R. 2695 represents only one example of the many efforts retailers are using to increase their profits at the expense of consumers. Merchants also want the price of debit card transactions to be the same as clearing checks (despite the numerous added benefits and costs associated with debit cards), and for retailers to have the authority to tell consumers they will not accept card payments if a card carries an interchange fee the merchant does not like – or if the consumer's total purchase value doesn't meet an identified threshold.

Additionally, retailers are seeking a back-door solution by asking Congress to give the Federal Reserve authority to set interchange fees, asking that agency to dictate marketplace pricing on what are clearly business-to-business transactions. All of these retailer profit-seeking initiatives fail to recognize that electronic payments are not just a substitution for cash payments, but provide consumers, merchants, and the economy with many more benefits, for which there is a cost.

Should Congress choose to establish price controls on interchange, consumers would be harmed, as lenders likely would pass on portions of merchants' costs to borrowers. Moreover, community banks and other small businesses would be significantly impacted. Community banks would no longer be able to provide various payment services on a par with their larger competitors, and thus no longer be able to serve their customers, with local communities suffering as a result. In sum, these initiatives would significantly harm the current marketplace.

We strongly urge you not to support H.R. 2695 or other similar efforts.

Sincerely,

American Bankers Association
Alabama Bankers Association
Alaska Bankers Association
Arizona Bankers Association
Arkansas Bankers Association
California Bankers Association
Colorado Bankers Association
Community Bankers Association of Ohio
Connecticut Bankers Association
Delaware Bankers Association
Florida Bankers Association
Georgia Bankers Association
Hawaii Bankers Association
Heartland Community Bankers Association
Idaho Bankers Association
Illinois Bankers Association
Illinois League of Financial Institutions
Indiana Bankers Association
Iowa Bankers Association
Kansas Bankers Association
Kentucky Bankers Association
Louisiana Bankers Association
Maine Association of Community Banks
Maryland Bankers Association
Massachusetts Bankers Association
Michigan Bankers Association
Minnesota Bankers Association
Mississippi Bankers Association
Missouri Bankers Association
Montana Bankers Association
Nebraska Bankers Association
Nevada Bankers Association
New Hampshire Bankers Association
New Jersey Bankers Association
New Mexico Bankers Association
New York Bankers Association
North Carolina Bankers Association
North Dakota Bankers Association
Ohio Bankers League
Oklahoma Bankers Association
Oregon Bankers Association
Pennsylvania Bankers Association
Puerto Rico Bankers Association
Rhode Island Bankers Association
South Carolina Bankers Association
South Dakota Bankers Association
Tennessee Bankers Association
Texas Bankers Association
Utah Bankers Association
Vermont Bankers Association
Virginia Bankers Association
Washington Bankers Association
Washington Financial League
West Virginia Bankers Association
Wisconsin Bankers Association
Wyoming Bankers Association

ELECTRONIC PAYMENTS COALITION

Statement of the Electronic Payments Coalition on H.R. 2695

U.S. House of Representatives
Committee on the Judiciary
April 28, 2010

Washington, D.C. – The Electronic Payments Coalition is pleased to submit the following statement on the House Judiciary Committee hearing on H.R. 2695:

> The Electronic Payments Coalition thanks the Judiciary Committee for the opportunity to present the facts in a hearing on H.R. 2695 – a bill that holds extraordinary potential for harming small financial institutions, competition in the debit, credit and charge card market, and ultimately the consumers served by this industry.
>
> Small financial institutions will typically offer debit and credit card products to their customers at or below margin – as a loyalty building and customer service tool. Should interchange revenue be forced down, as proposed in this bill, these community banks and credit unions will face an impossible decision of raising rates, eliminating rewards programs, or stopping their card programs altogether. Customers of credit unions and community banks will have fewer choices with reduced competition in the market.
>
> In Australia, where regulators forced down interchange rates below market value, this is precisely what happened. Merchants saw hundreds of millions of dollars in increased revenue, with no evidence that consumers saw any savings at the register. Moreover, consumers saw the return of annual fees on their cards, reduced or eliminated rewards programs, and a less competitive marketplace for debit and credit cards.
>
> Merchants receive guaranteed payment, increased profits, and reduced expenses when they accept cards. But they do not want to pay for these benefits, and are attempting to shift this business expense onto their customers. We urge Congress to oppose H.R. 2695, a bill that will reduce competition, harm small financial institutions, consumers, and our economic recovery.

For more information, contact Trish Wexler at trish@electronicpaymentscoalition.org or (202) 288-1238.

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About Electronic Payments Coalition

The Electronic Payments Coalition is dedicated to protecting consumer value, choice, and competition in electronic payments systems. The coalition is a broad-based group of payment card networks, financial services companies, and financial services trade associations whose primary goal is to educate policy-makers, consumers, and the media about the value of electronic payments systems — including economic growth, convenience, speed, reliability, and security — and to ensure the continued growth of global commerce by promoting consumer choice and the stability of the vast payment networks that connect millions of consumers with millions of retailers each and every day.

CUNA & Affiliates

Credit Union National Association, Inc.
601 Pennsylvania Avenue NW
South Building, Suite 600
Washington, D.C. 20004
(202) 638-5777

**STATEMENT OF THE
CREDIT UNION NATIONAL ASSOCIATION (CUNA)
BEFORE THE HOUSE JUDICIARY COMITTEE
HEARING ON**

H.R. 2695, the "Credit Card Fair Fee Act of 2009"

April 28, 2010

STATEMENT OF THE
CREDIT UNION NATIONAL ASSOCIATION (CUNA)
BEFORE THE HOUSE JUDICIARY COMITTEE
HEARING ON

H.R. 2695, the "Credit Card Fair Fee Act of 2009"

April 28, 2010

Chairman Conyers and members of the Committee, thank you for the opportunity to provide a written statement on H.R. 2695, the "Credit Card Fair Fee Act of 2009" on behalf of the Credit Union National Association (CUNA). CUNA is the largest credit union advocacy organization, representing over 90 percent of our nation's 8,000 federal and state chartered credit unions and their nearly 92 million members.

Credit unions strive to meet their members' financial needs, and credit and debit cards obtained through credit unions have competitive rates and consumer-friendly terms, offering members important financial options to manage their finances more efficiently.

Of the approximately 92 million credit union members nationwide, 98% belong to a credit union issuing debit cards and 84% belong to a credit union issuing credit cards. Credit unions are proud to issue debit and credit cards to their members. Credit unions can offer these products because of interchange, the transaction fee that flows from the merchant, through its bank, to the credit union that issued the card to the consumer. Interchange helps the credit union cover its expenses and losses. In some cases, these expenses and/or losses far exceed the amount of interchange revenue a credit union receives. Merchants benefit as they are guaranteed payment at the time the transaction is completed.

CUNA opposes legislation intended to reduce the interchange responsibility of the merchants because consumers will not see a benefit as a result of any reduction in the merchants' interchange responsibility, and actually could be harmed by the legislation; credit unions would continue to experience expensive merchant data breaches with reduced resources; and credit unions would not be exempt from the result of the proposed negotiation structure in the pending interchange legislation.

Consumers Will Not See a Benefit, and Could Be Harmed

H.R. 2695 would artificially lower interchange rates and force credit unions to accept less revenue from the payments system. Merchants have argued that lowering interchange rates would be good for consumers, but if that were true, they would have supported an amendment offered during the Committee's 2008 consideration of this legislation that would have directed merchants to pass on to the consumer any savings they received from lower interchange rates. If this legislation is truly in the best interests of consumers, merchants would have supported this amendment; however, they did not and the amendment failed.

If forced to accept lower interchange fees that would result from this legislation, many credit unions and other smaller institutions would re-evaluate their credit and debit card offerings, and possibly exit the market. This would result in consumers having fewer credit and debit cards from which to choose, forcing them to rely on only a handful of large issuers for credit and debit cards.

Supporters of this legislation assert that consumers would benefit from government interference, but there is no clear indication that this objective will be met. Granting merchants an anti-trust exemption on interchange fees is more likely to increase credit and debit cards costs that consumers bear.

It is unlikely that consumers will see any benefit from this legislation, and it is more likely that they will be harmed by this legislation because credit and debit cards would be less available and more expensive.

Credit Unions Would Continue to Experience Expensive Merchant Data Breaches

Merchants are guaranteed payment at the time the consumer's transaction is completed. When a data breach occurs at a merchant's site, the card-issuing credit union is the one bearing the immediate financial responsibility to make things right for the affected consumer. Credit unions bear the cost of replacing cards, shoring up member accounts, and often have to deal with the perception that they were at fault for the breach since the merchant does not have to disclose when they are the source of the data breach. Costs borne by a credit union for a data breach can often run in the hundreds of thousands of dollars per event. Litigation can take years and a vast amount of resources for the affected credit union, so the merchants either delay or avoid their responsibility for the breach.

At today's hearing, the Committee will hear from a witness, David Carpenter, representing the National Association of Convenience Stores. Mr. Carpenter owns a conglomerate that includes gas stations, convenience stores, and car wash outlets in Iowa. In 2007, a data breach occurred at a Kwik Stop convenience store in southeast Iowa. Kwik Stop is a competitor of Carpenter's "ShortStop" convenience stores. According to local financial institutions, magnetic strip data (containing ATM, debit card, and credit card numbers) was obtained from the Kwik Stop terminal and the breach occurred over a period of three years.

The impact of the Kwik Stop breach on local financial institutions was significant. For example, Dupaco Community Credit Union of Dubuque, had to reissue over 7,000 cards, costing its credit union member-owners approximately $78,000 (not including staff time); the fraud loss from this breach was approximately $100,000. Another financial institution, Liberty Bank, where Mr. Carpenter sits on the board, likely also incurred significant costs associated with this single breach.

Despite the effect that breaches like the Kwik Stop breach have on local community banks and credit unions, merchants continue to push for legislation like H.R. 2695. Merchant's insistence on an anti-trust exemption illustrates their refusal to bear some responsibility for securing the payments system and paying their fair share of the costs of the system. Ironically, it also highlights the fact that merchants enjoy significant costs savings and benefits under the current system; nevertheless, they want more.

Credit Unions Would Not be Exempt from the Result of the Proposed Negotiation Structure in the Pending Interchange Legislation

Under H.R. 2695, credit unions and community banks are exempted from the anticipated negotiation sessions where the merchants will have an antitrust exemption advantage. Assuming the large merchants and the large financial institutions emerge from the negotiation sessions with a new and improper interchange rate, all card-issuing financial institutions in the card networks will receive the same interchange. Therefore, while a credit union may be excluded from the negotiation session, it will still be subject to the artificially lower interchange. The reduced interchange will result in higher fees for the consumer, reduced competition for consumer-friendly terms, and the high probability that some credit unions may have to discontinue their debit or credit card programs.

In conclusion, under H.R. 2695, merchants win and consumers lose. Merchants win because the anti-trust exemption allows them to collude and artificially lower their cost to accept debit and credit cards. Consumers will lose because an artificially lower interchange fee rate will mean fewer credit unions and community banks will offer cards to their members and customers, which will reduce availability and increase costs for consumers.

On behalf of America's credit unions and their 92 million members, we urge you to oppose the legislation and thank you for your consideration of our views.

Mr. SMITH. Also, as I did in the last Congress, I wrote the Department of Justice and the Federal Trade Commission on April 15, 2010, to request their views on this legislation. Unfortunately, only the FTC responded to my request in a timely manner. I thank them and would like to submit their record—their letter for the record as well. As in the previous Congress, the FTC raised concerns about granting such a large antitrust exemption.

[The information referred to follows:]

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Secretary

April 27, 2010

The Honorable Lamar Smith
Ranking Member
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Smith:

Thank you for your April 15, 2010 letter to the Federal Trade Commission requesting views on H.R. 2695, the Credit Card Fair Fee Act of 2009, with a particular focus on the advisability of the bill's approach and potential administrative burdens for the Commission. As you know, by longstanding agreement the Commission and the Antitrust Division coordinate their antitrust actions to avoid duplication and maximize the effectiveness of federal antitrust enforcement. The Antitrust Division for many years has handled antitrust oversight of financial services markets, and I therefore defer to the Antitrust Division as to the merits of the proposed legislation. However, based on the Commission's general expertise in competition matters, I can offer a few global comments.

As a general matter, the Commission has long disfavored exemptions from the antitrust laws. As you know, in its final report, the Antitrust Modernization Commission ("AMC") reiterated what most scholars have believed for years -- that exemptions from the antitrust laws should be disfavored -- and urged Congress to exercise caution.[1] Accordingly, the AMC recommended that statutory immunities be granted "rarely" and only where proponents have made a "clear case" that exempting otherwise unlawful conduct is "necessary to satisfy a specific societal goal that trumps the benefit of a free market to consumers and the U.S. economy in general."[2] The Federal Trade Commission has for many years similarly held the

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1 Antitrust Modernization Commission, Report and Recommendations (April 2007), *at* http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf

2 *Id.* at 335.

The Honorable Lamar Smith -- Page 2

view that proponents of setting aside competitive forces should bear a heavy burden of demonstrating, with factually-supported reasons, the need to depart from the nation's competitive model.

We appreciate your interest in this matter, and hope that the foregoing information is of assistance. If you or your staff have questions, please contact Jeanne Bumpus, the Director of our Office of Congressional Relations, at (202) 326-2195. Please also let us know whenever we can be of assistance with respect to any other matter.

Sincerely,

Donald S. Clark

Donald S. Clark
Secretary of the Commission

Mr. SMITH. I would also like to introduce into the record a letter from the previous Administration's antitrust division that expressed similar concerns about granting antitrust exemptions. I am hopeful that we will get an updated letter from this Administration soon on the same subject.

[The information referred to follows:]

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

June 23, 2008

The Honorable Lamar Smith
Ranking Member
Committee on the Judiciary
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Smith:

This responds to your letter, dated June 2, 2008, requesting the Department of Justice's views on H.R. 5546, the "Credit Card Fair Fee Act of 2008". We appreciate the opportunity to provide the Department's views.

Section 2(c) of this bill creates a broad immunity under the antitrust laws for merchants and issuers jointly to negotiate interchange fees and terms of access to a credit and/or debit card network above a certain size. For all merchants and issuers that are unable to reach agreement, section 3 of the bill establishes a panel of Electronic Payment System Judges that will establish access rates and terms. The Payment System Judges are to be appointed and supported by the Antitrust Division and the Federal Trade Commission Bureau of Competition, an arrangement that the Department believes conflicts with the Appointments Clause, as discussed further below.

The antitrust laws are the chief legal protector of the free-market principles on which the American economy is based. Companies free from competitive pressures have incentives to raise prices, reduce output, and limit investments in expansion and innovation to the detriment of the American consumer. Accordingly, the Department has historically opposed efforts to create sector-specific exemptions from the antitrust laws. The Department believes that antitrust exemptions can be justified only in very rare instances, when the fundamental free-market values underlying the antitrust laws are compellingly outweighed by a clearly paramount and clearly incompatible public policy objective. Moreover, any such legislation establishing an antitrust exemption should be narrowly drawn and carefully tailored to avoid unintended consequences. Consequently, the Department has serious concerns about this legislation for a variety of reasons.

First, this bill may actually harm to consumers, not benefit them. The credit and debit card markets are complex, so-called "two-sided" markets in that each network needs to attract both cardholders and merchants. Pricing on one side of the market impacts the pricing on the other side. For example, newspapers charge less to readers in order to increase sales and circulation, thereby making their paper more attractive to advertisers. Revenues from advertisers support the lower prices to readers. Similarly, credit card networks forced by regulation to collect less from merchants may well respond by charging more to cardholders in card fees, or reducing card rewards programs and other features that are attractive to consumers. Indeed, a recent GAO Report, *Credit and Debit Cards*, GAO-08-558 (May 2008), suggests this may be what happened in Australia when Visa and MasterCard's interchange rates where capped. The

GAO reported that "consumers have experienced a decline in the value of credit card reward points for most cards and an increase in annual and other consumer credit card fees." GAO Report at 35. Although there remains the important question of whether consumers paid sufficiently less for credit card purchases to compensate for these effects, the GAO Report does raise questions regarding whether legislation regulating rates on one side of the network would benefit competition and consumers.

Second, the bill seeks to counter perceived market power on the part of large credit card networks by establishing market power on the part of merchants negotiating with those networks. It would do this by exempting from the antitrust laws joint negotiations of merchants with any network electronic payment system that has been used for at least 20% of the combined dollar value of U.S. credit, signature-based debit, and PIN-based debit card payments. From a policy perspective, the Department does not support legislatively establishing a buy-side monopoly (or monopsony) to counteract any existing market power. Such a result may well increase, not decrease any existing harm to competition and consumers. Indeed, the joint negotiations among merchants exempted by the bill appear to be the type of naked collusion that the antitrust laws condemn as per se unlawful because such conduct lacks plausible benefits to competition. Moreover, the ability of merchants (and issuers) to discuss, jointly negotiate, and agree upon fees and terms with one network could lead to an implicit understanding on what fees and terms to accept from other networks, including networks not encompassed by this legislation. Such a spillover effect would diminish, not enhance, competition between payment card networks, which is the best and most productive way to ensure that consumers are protected and benefitted.

Third, suppressing competition pursuant to what is essentially price-control legislation is likely to be inefficient and costly, thereby harming consumers. Section 3 of this bill creates a panel of Electronic Payment System Judges that would resolve disputes if issuers and merchants were unable to voluntarily reach a jointly-negotiated agreement. The Department does not support the creation of a regulatory panel to set rates and terms of access. Generally, regulation should be confined to the fewest areas possible, and even then should be narrowly tailored to address a clearly demonstrated market failure. Notwithstanding the best of intentions and goals, the regulator will be imperfect in its attempt to replicate the terms that would be reached in a competitive market. Moreover, a panel of regulators cannot replicate the flexibility that is found in the free market. This bill imposes inflexibility into the terms and fees by requiring all terms to apply across all merchants and issuers that do not reach an agreement and by setting the same fee and terms for a period of two or three years.

Fourth, the Department believes that the method of appointment of Payment System Judges in section 3 conflicts with the Appointments Clause. By giving Payment System Judges authority to issue binding decisions setting rates and terms of access to credit card networks, as well as authority to assess civil penalties for failure to comply with collateral orders, the bill appears to vest a portion of the sovereign authority in the Payment System Judges, making them "Officers of the United States" for purposes of the Appointments Clause. *See* Memorandum

Opinion for the General Counsels of the Executive Branch, *Officers of the United States Within the Meaning of the Appointments Clause* at 1, 12-13 (Apr. 16, 2007), available at http://www.usdoj.gov/olc/2007/appointmentsclausev10.pdf ("delegated sovereign authority . . . is power lawfully conferred by the Government to bind third parties," and includes power to "issue regulations and authoritative legal opinions" and "impose penalties"). The Payment System Judges would likely be inferior, rather than principal officers, because the bill gives the Antitrust Division and Federal Trade Commission Bureau of Competition authority to sanction or remove Payment System Judges; accordingly, Congress may only vest authority to appoint these officers "in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. Const. art. II, § 2, cl. 2; *see Edmond v. United States*, 520 U.S. 651, 662-63 (1997) (stating, as a general rule, that "'inferior officers' are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate"). The Antitrust Division and Federal Trade Commission Bureau of Competition do not fall within any of these categories and therefore may not statutorily be granted authority to appoint the Payment System Judges.

In addition to these constitutional concerns, the process outlined in sections 3 and 4 of this bill imposes significant burdens on the Antitrust Division and the Federal Trade Commission Bureau of Competition. This bill requires the Antitrust Division to consult with Payment System judges and issue or approve regulations relating to proceedings. The Antitrust Division is a law enforcement agency. It has not performed these functions in the past, does not have the resources to do so currently, and such a requirement likely would detract from the Division's law enforcement mission. The administrative support the agencies are expected to provide the Electronic Payment System judges—by, for example, representing the tribunal of judges before the Circuit Court—is likely to impose substantial burdens, as litigation is almost certain to arise from any decisions of the tribunal and is likely to be extensive and complicated.

For the foregoing reasons, the Department has serious concerns about this bill and the burdens the bill imposes on the Antitrust Division and the Federal Trade Commission Bureau of Competition.

Please do not hesitate to call upon us if we may be of additional assistance. The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to submission of this letter.

Sincerely,

Keith B. Nelson
Principal Deputy Assistant Attorney General

cc: The Honorable John Conyers, Jr.
Chairman

Mr. SMITH. I thank you, Mr. Chairman. If I could have all those documents made—be made a part of the record I would appreciate it.

Mr. CONYERS. Be pleased to include them in the record.

Mr. SMITH. All right. Thank you, Mr. Chairman. I yield back.

Mr. CONYERS. Anybody else on the Committee have a brief opening comment?

Mr. SENSENBRENNER. Mr. Chairman?

Mr. CONYERS. Jim Sensenbrenner?

Mr. SENSENBRENNER. Mr. Chairman, first I would like to ask unanimous consent that this statement for the record from the Financial Services Roundtable in opposition to this bill be included in the record.

Mr. CONYERS. Absolutely.

[The information referred to follows:]

STATEMENT FOR THE RECORD

THE FINANCIAL SERVICES ROUNDTABLE

On

The U.S. House of Representatives Committee on Judiciary Hearing on

"H.R. 2695, the "Credit Card Fair Fee Act of 2009"

House Judiciary Committee

April 28, 2010

The Financial Services Roundtable ("Roundtable") respectfully offers this statement for the record to the United States House Judiciary Committee hearing on H.R. 2695, the "Credit Card Fair Fee Act of 2009.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

I. The Roundtable Supports the Current Interchange Fee System:
Payment cards, specifically financial institution-issued credit and debit cards are a mainstay of today's global economy. Consumers who use payment cards issued by a financial institution realize benefits such as convenience, flexibility, fraud protection, and security from carrying cash. With the advent of web-based commerce, consumers can now make purchases from retailers all over the world.

The benefits from accepting payment cards, such as guaranteed payment and increased merchant sales, are indisputable. Businesses are free to participate in payment systems developed by financial institutions as they see fit. In exchange for these benefits, there is an interchange fee for accepting and processing purchases with payment cards. Competition drives the level of these fees.

Financial institutions that issue payment cards provide consumers and businesses with benefits as well. These include safe, secure, and reliable networks to process the transactions, and, in many cases, the assumption of liability. The Roundtable believes competition, not government-imposed price controls, should continue to determine interchange fees. This competition benefits consumers, as well as all parties involved in the payment transactions.

II. The Roundtable Opposes Altering Current Interchange Fee Structure:
In an effort to lower their costs of doing business, retailers want to arbitrarily determine rates and terms for interchange fees and in effect transfer the merchant's business cost directly to consumers. **The Roundtable opposes the regulation of interchange fees and any attempt by merchants to shift their business costs to consumers.**

Merchants benefit from the current payment structure. According to a November 2009 report issued by the Government Accountability Office, both merchants and consumers benefit greatly from the current interchange fee structure. Further, the report does not demonstrate any clear benefit to consumers by modifying the interchange system and shifting costs from retail businesses to consumers. In short, the present interchange fee structure allows for seamless transactions at point-of-sale (POS) for both parties. Merchants benefit through reduced risks, receive instant payment on card transactions, and increased revenue. Consumers benefit by having various options to choose from when they are making a purchase. Additionally, when private consumer information is comprised, it is the financial institution, not the store, that is burdened with the additional cost and accompanying losses – including the accompanying reputational risk.

III. The Roundtable Opposes H.R. 2695:

The Financial Services Roundtable respectfully opposes H.R. 2695, the Credit Card Fair Free Act of 2009, sponsored by House Judiciary Committee Chairman, Representative John Conyers (D-MI). If enacted, H.R. 2695 will shift merchants cost to participate in the electronic payment system to consumers, and reduce the variety of credit and debit card products available today. The Roundtable respectfully urges the Judiciary Committee to oppose this measure.

The antitrust exemptions included in H.R. 2695 would allow giant retailers to band together to "negotiate" something that most merchants, both large and small, are already able to do. In addition, a number of government agencies – including the Department of Justice, the Federal Trade Commission, and the Government Accountability Office have clearly stated that this legislation would end up hurting consumers in the form of higher fees.

The Roundtable believes that interchange rates and governance should be set by free private sector market forces. Interchange is the fee that retailers pay to access the credit and debit card payment system. Retailers that use the system are provided the benefit of safe and guaranteed payments transferred directly into the merchant's accounts, along with the transactions that are less expensive than cash or checks. The retailers bear no risk associated with fraud, failure to pay, or data breaches. When merchants choose to accept payment cards, they pay a penny or two on each dollar for the ability to accept electronic payments. The interchange fee is a very small price to pay for all of these benefits.

IV. Conclusion:

The Financial Services Roundtable opposes H.R. 2695 and any legislative proposal that seeks to alter the current interchange fee structure that has developed and evolved over the last 30 years by market forces. The present system benefits merchants and financial institutions, and provides convenience to consumers. Redesigning the present system would shift costs to consumers, and reduce the variety of credit and debit card products available today.

Mr. SENSENBRENNER. Mr. Chairman, I don't think this bill is much better than the previous bill, and I hope that this Committee defeats it. No merchant is required to accept credit cards. Some merchants avoid interchange fees altogether by issuing their own store cards, and Macy's and Nordstrom's have been very successful in doing that by offering their customers better perks than Visa and MasterCard offer, and as a result they avoid the interchange fees.

But I would like to point out that the interchange fees actually give the merchants a benefit. Before plastic was invented many stores had store accounts of various formality and informality, and if a customer did not pay their store account that had to be written off by the merchant.

With plastic, the interchange fees pay for the bank or the issuer of the credit card having to absorb any nonpayment, and as a result, the merchant gets paid in full and the credit card issuer either gets stiffed for that amount or has to go through the cost of collection. And I think that that is very valuable for the merchant and they also ought to be required to pay for it.

And I am afraid that when I have been showing up at the convenience store I am seeing these petitions that they have got on the table. It is apparent to me that the merchants don't want to pay for it, number one; and number two, they are giving the impression that if the interchange fees go away then prices will go down. Anybody who believes that, I have a bridge in Brooklyn to sell at a very reasonable price once the hearing is over with.

I yield back.

Mr. CONYERS. I don't think I have been very successful over the last couple years.

Anybody else want to comment?

Steve, do you want to—Steve King, you want to introduce the first witness?

Mr. KING. I would very much appreciate the opportunity to do so, Mr. Chairman.

All right, it is—our first witness, it is my pleasure to introduce a fellow Iowan at today's hearing, that is Dave Carpenter. He is a true Hawkeye.

And he has a degree in business from the University of Iowa. He is the president of J.D. Carpenter Companies, Incorporated.

Dave is the owner and president of ShortStop. It is a chain of six convenience stores that are located throughout Des Moines and eastern Iowa.

In 2002 Dave also became owner and board director of Liberty Bank. He may not know this, but some years ago they essentially bought my line of credit during a bank crisis, so—but he brings an interesting perspective to this hearing because of his background in retail and in banking, and I welcome today Dave Carpenter.

And I look forward to your testimony.

Thank you, Mr. Chairman, and I yield back.

Mr. CONYERS. Thank you. That is a pretty good introduction for a person that didn't support the bill last time. Maybe you can do a better job.

Welcome to the hearing.

TESTIMONY OF DAVE CARPENTER, PRESIDENT, J.D. CARPENTER COMPANIES, INC., ON BEHALF OF THE NATIONAL ASSOCIATION OF CONVENIENCE STORES

Mr. CARPENTER. Chairman Conyers, Ranking Member Smith, and Members of the Committee, thank you for your inviting me to share my views regarding credit card swipe fees.

And thank you to Congressman King for your kind introduction.

My observations are based on my experience both as an owner of a chain of six convenience stores in Iowa and part owner of a large community bank, also in Iowa. I am testifying today on behalf of the National Association of Convenience Stores, of which I am a member.

In the last 6 months, NACS has delivered petitions with more than 3.7 million signatures from our customers asking Congress to create transparency and competition for swipe fees. We and our customers are hoping Congress is listening.

Five minutes is not enough time to tell—for me to tell my story, so I urge you to read my written testimony, which explains our problems with interchange fees. My community bank has more than $1.2 billion in assets. We issue cards, but the value to our bottom line is de minimis.

I do not understand how any bank the size of mine or smaller could make any money from interchange fees. Most small banks have to outsource card operations. The big banks are the only ones that make money on interchange. If interchange is reduced it will not have a material effect on my bank, and a more competitive market might even give us a chance to compete and do better.

What happens with the gasoline market is a great example of how competition should work here. I negotiate every day on wholesale prices for the fuel I buy, but I cannot negotiate interchange with MasterCard and Visa. Therefore, I fully support the Credit Card Fair Fee Act of 2009 and other efforts to help reign in swipe fees.

When various major expenses are compared to our six stores it can clearly be seen that credit card fees are our second-largest expense. Only labor costs us more.

For some of my stores credit card fees exceed even labor. For one of my stores, the amount we pay in credit card fees is twice what we pay for rent, four times more than utilities, and 30 times more than health insurance. Six stores even paid $130,000 last year in card fees on the amount we collect in state fuel tax.

We did one analysis to demonstrate just how much it takes in card fees for us to sell fuel. We found that it takes more than half of the gallons we sell and the associated margin just to pay the card fees. Overall, for the ShortStop chain, interchange fees have grown more rapidly and significantly than all of our other expenses.

An especially problematic aspect of interchange fees hikes we have seen in recent years is that they are completely unpredictable. We are able to predict most of our costs accurately. Approximately 80 percent of ShortStop sales are paid by credit and debit cards, and we have no other options.

Policymakers truly need to see payment cards as a new form of currency, because 80 percent of our sales—and growing—that is what payment cards have become and will be in the future. With lower interchange fees I would lower prices and would have more capital to invest in providing jobs for my community.

Turning to the community bank, of which I am a part owner, in 2009 the amount of revenue the bank earned on interchange accounted for less than 1 percent of our total revenue. The amount of profit in the bank that interchange accounted for was zero.

The reason we issue payment cards is purely for the convenience of our customers. Many small banks outsource card issuance, a model likely to yield little or no profit. This is why I disagree with the contention that efforts to bring interchange fees under control will harm community banks. If interchange is cut we would continue to offer cards to our customers as a service.

In fact, changes to the system might help. Right now we compete with other banks for customers in every other part of our business on the basis of price and service, but there is no price competition on interchange.

If there were, we might have more ways to attract customers and increase this part of our business. But the way it is, the huge banks make big money on interchange and market heavily to our customers through direct mail and otherwise. There is not other aspects of the bank's operation in which we charge the same set of default rates—default fees or prices as all of our competitors.

I am an entrepreneur and believe in free markets, and what I know is this: Legal or not, the interchange market isn't free. It is rigged to guarantee big money for the largest banking institutions without helping banks like mine.

I see the effects of card swipe fees from the perspective of a retailer as well as a community banker. These fees are out of control. All we are asking for is the ability to negotiate these fees.

Thank you.

[The prepared statement of Mr. Carpenter follows:]

PREPARED STATEMENT OF DAVE CARPENTER

WRITTEN STATEMENT OF

DAVE CARPENTER
PRESIDENT, J.D. CARPENTER COMPANIES, INC./SHORTSTOP CONVENIENCE STORES
MEMBER OF THE BOARD OF DIRECTORS, LIBERTY BANSHARES

ON BEHALF OF
THE NATIONAL ASSOCIATION OF CONVENIENCE STORES

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY

HEARING ON THE "CREDIT CARD FAIR FEE ACT OF 2009, H.R. 2695

APRIL 28, 2010

Chairman Conyers, Ranking Member Smith and Members of the Committee, thank you for inviting me to share my views regarding payment card "swipe" fees. My observations are based on my experience both as the owner of a chain of convenience stores and part owner of a large community bank. From either of my vantage points, these fees have long been out of control, and they are nearly suffocating my retail stores while yielding no profit at all for my community bank. Therefore, I fully support the Credit Card Fair Fee Act of 2009 and other efforts to help rein in swipe fees.

Overview

I am owner and President of ShortStop, a chain of six convenience stores. The stores are located in Des Moines and other locations in eastern Iowa. This is a family business, and I started working in the business as a young teen, continuing through college, until my father died in 1996 and I took over running the business. Fuel sales make up a large part of our sales, but we also sell a wide array of beverages, prepared and packaged food, and other convenience items.

I am testifying today on behalf of the National Association of Convenience Stores ("NACS"), of which I am a member. NACS is an international trade association representing the convenience store industry. The industry as a whole includes about 145,000 stores in the United States, sells nearly 80 percent of the gasoline in the nation, and employs about 1.7 million workers. It is truly an industry for small businesses, and more than 60 percent of convenience stores are owned by one-store operators. Because of the tremendous, detrimental impact that swipe fees are having on convenience stores, NACS has long advocated for a more competitive and transparent system of payment card interchange fees, and I support these efforts.

Indeed, I want to make sure Committee Members are aware that yesterday, NACS delivered a petition with more than 2 million signatures from our customers asking Congress to create transparency and competition for swipe fees. This is on top of the 1.7 million signatures 7-Eleven delivered last year, bringing the total to 3.7 million Americans who have taken time from their busy day to sign a petition asking Congress to act. We and our customers hope Congress is listening.

In 2002, I became an owner and board member of Liberty Bank Iowa. Liberty Bank Iowa has more than $1 billion in assets and 30 locations throughout central and eastern Iowa. I am now a member of the board of directors of Liberty Banshares, the holding company for Liberty Bank Iowa. Unlike many community banks, Liberty Bank Iowa issues its own Visa credit and debit cards, rather than outsourcing our card operations.

Because of my roles as a retailer as well as co-owner of a community bank, I am in the unique position of understanding the effect that runaway card fees have on convenience stores, as well as the negligible impact of payment card operations on community banks' profitability.

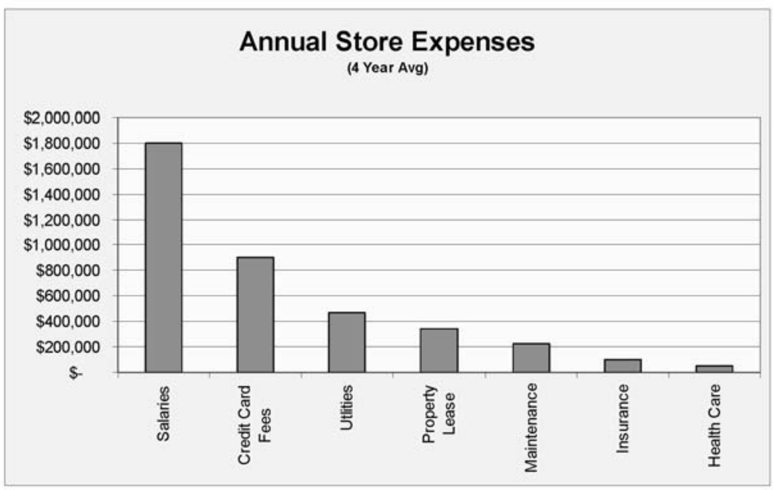
The first part of my statement will discuss the effect that swipe fees are having on my retail business. Thereafter, I will describe Liberty Bank Iowa's payment card business.

<u>The Impact of Runaway Credit Card Fees on My Convenience Store Business</u>

I know that this is not the first hearing this Committee has held on card fees, so you no doubt are aware that for the last four years, our industry as a whole has paid more to credit card companies to simply process our card payment transactions than we earned in pre-tax profits. My aim today is to describe what all of this means at the store-owner level.

The following data demonstrate how dramatically runaway interchange fees have affected my business. First, as shown in Figure 1, when various major expenses are compared for our six stores, it can clearly be seen that card fees are our second largest expense.

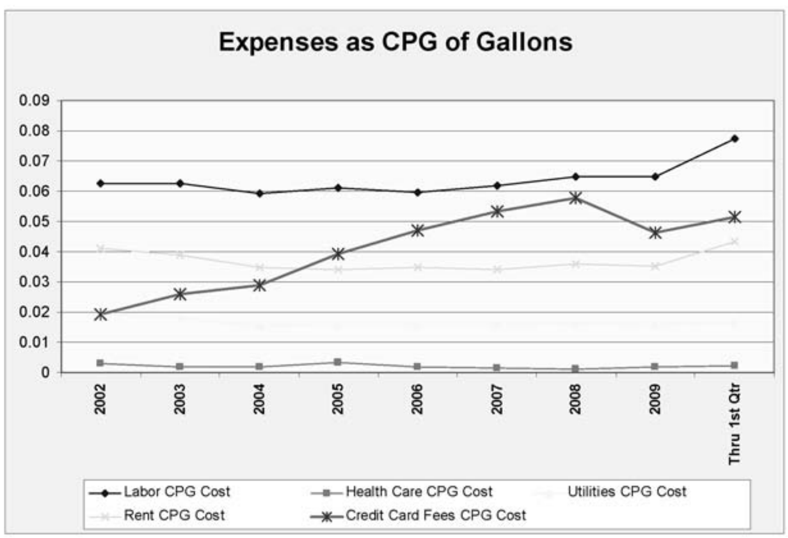
Figure 1



Only labor costs us more. ShortStop pays higher than average wages for the convenience store industry, so interchange fees likely represent an even larger chunk of expenses for the typical convenience store. I note, however, that Figure 1 reflects average figures for the entire chain. For some of my stores, card fees exceed even labor costs. For one of my stores, the amount we pay in card fees is twice what we pay for rent, four times more than utilities, and thirty times more than health insurance. I'm even paying card processing fees on the amount of each sale that we collect as taxes. Last year we paid more than $130,000 in swipe fees just on state and federal gasoline tax. We also pay swipe fees on any local or state sales tax. That is money that I don't even get, but I am paying interchange on it.

Figure 2 calculates certain store expenses by the number of gallons to determine a cost-per-gallon basis for two representative stores.

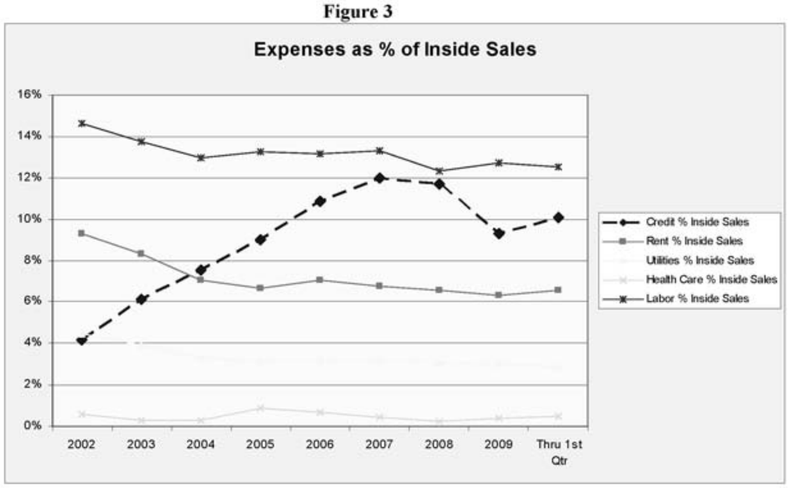
Figure 2



This analysis confirms that over the last five years, card fees have been the second largest expense we incur on each gallon of fuel we sell. It also shows the runaway pace of increases in our card fee expense, particularly when compared to our other major expenses. [1]

To eliminate any influence that fluctuations in fuel sales price might have on our calculations, in Figure 3 we performed the same analysis using convenience store sales.

Figure 3

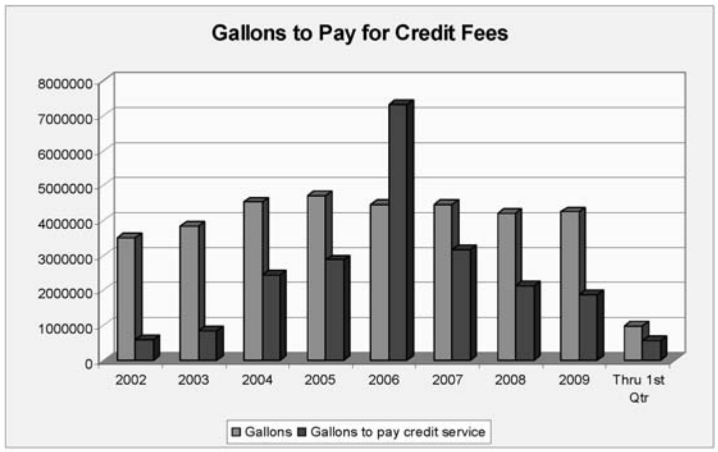


Dividing convenience store sales by certain store expenses, the result was the same – card fees are the second largest expense we incur, and the runaway nature of our swipe fees is plainly evident.

[1] The decline in credit card fee expense reflected in Figure 2 for 2009 is the result of the precipitous drop in gas prices that year after the price spiked the year before. As can be seen from the data for first quarter 2010, our card fee expense is on its way up once more. While the trends for other expenses also appear to be rising for the first quarter 2010, this is due only to the fact that gasoline sales volume in the first three months of the year is historically low in Iowa. When our expense data are viewed over an entire year, the slope of the lines for all expenses other than card fees remains relatively flat.

Figure 4 shows just how much it takes in card fees for us to sell fuel.

Figure 4



Taking sales and card fee data from one representative store, and separating out card fees paid on fuel sales only, it can be seen that on average, it takes **more than half** the gallons we sell and the associated profit just to pay the card fees. And in 2006, we were unable to sell enough fuel even to pay for the swipe fees on those sales. For some of our stores, this situation was not limited to 2006 and is a recurring issue because our margins on fuel sales are very low. In any event, these figures help demonstrate just how competitive our industry is, with retailers unable to earn enough to cover one of their significant expenses.

Importantly, none of these graphs account for fee hikes that Visa has announced for this month and July. I know of a company that has estimated that these hikes will result in a 5.9% increase in card fees paid on fuel sales alone. And these increases are not for interchange – they relate to the myriad of other fees the card companies charge merchants, such as the Assessment Transaction Fee, Partial Authorization Fee, Zero Floor Limit Fee, and various debit card fees. If you thought the fees on telephone bills were confusing, you should take a look at the tangle of fees charged for card processing.

And somehow, Visa's and MasterCard's supposed efforts to mitigate some of the fee burden for fuel sales ends up costing us more. Last year, they instituted a "small ticket fee" program to charge a lower fee for fuel sales transactions of less than $75. To provide some background, the Committee may recall that in 2008 when fuel prices spiked, card fees rose to unprecedented levels. When those were combined with the card companies' draconian rules that allowed them to refuse to pay retailers for sales over $75, the result was lost sales for retailers and upset customers because gas pumps automatically shut off at $75, before some customers' tanks were full. Customers who re-set the pumps to get more gas caused the retailer to pay a second, full swipe fee.

It should come as no surprise that the small ticket program, which was supposed to address these difficulties, comes with strings. First, when the increases in other components of card fees are taken into account, this change to the fee structure does not help my business, and will probably cost us more. This is the case because the small ticket program involves a decrease in the percentage-based portion of the swipe fee and an increase in the flat fee portion of the swipe fee. When gas prices went back down, the overall proportion of the swipe fee as a percentage of the sale actually went up, and is higher than it was under the old program.

Moreover, even if a fuel customer goes one penny over $75 in a transaction, the merchant goes from paying the "best rate" for fees on the total sale to the "worst rate," which is nearly double the "best rate." The card companies also refuse to give merchants any assurances regarding charge-backs on transactions greater than $75. So if a fuel transaction is more than $75, the merchant takes the risk on any amount above $75. And there currently is no authorization system that will allow merchants to avoid these types of risks, although we hear that Visa is working on one that might be made available a few years from now. The best a retailer can do is set a pump limit at $75, which is inconvenient for customers re-fueling trucks and other large vehicles because the pump shuts off and they must initiate an entire new transaction. And as mentioned, the retailer is charged a full, second swipe card fee for that second transaction even though it's the same customer simply trying to fill his or her tank.

Overall for the ShortStop chain, interchange fees have grown more rapidly and significantly than **all** of our other expenses. And we cannot control interchange fees the way we can control other expenses. For example, we could change employee schedules if we needed to reduce labor costs; we can invest in new technology to reduce utility expenses; and we put our business and health insurance needs out for competitive bid yearly to help keep those expenses at a manageable (or at least predictable) level.

But our interchange fees are what they are, and we have absolutely no ability to negotiate those fees. As a result, we have had to cut costs even more in other areas to offset the increases in card fees. Our customers and employees are financially stressed. Yet, the customer must pay more for everything he or she purchases, and our employees may have their hours cut, their benefits cut, or get no raises. And stores may lose money, or fail to grow enough to adequately distribute overhead costs. My business has not expanded as it could because of runaway card fees. Thus, any particular cost that we cannot control actually has a far broader, negative impact on every aspect of our business, our employees, and our customers.

To propose that we simply use cash discounting reflects a lack of understanding of this retail business. Fuel sales are so competitive – every station has its prices on big signs outside for all to see – that if we advertised a lower price for using cash, some competitors would match our price for credit transactions at their stations. The competition would kill us. And because of the credit card companies' onerous labeling rules for cash discounting, attempting to discount the thousands of other items we sell inside the store would be an impractical, logistical nightmare. Unlike Visa and MasterCard, our industry isn't permitted to agree on pricing schemes for our stores. Instead, the incredibly competitive nature of our business gives our customers the best price possible in their respective market, and keeps us constantly looking for ways to improve our sales and cost structures.

An especially problematic aspect of the interchange fee hikes we have seen in recent years is that they are completely unpredictable. While we obviously cannot expect that prices will always be predictable, given the years of experience my staff and I have in this business, we are able, for the most part, to accurately project the cost of large expense items. With the exception of credit card fees. As a case in point, I went to a bank in 2002 to obtain capital financing to expand, and I submitted a budget with estimated expenses to the bank. My estimate was extremely accurate for every expense with the exception of credit card fees, which had risen so dramatically during a period of just a few years that they exceeded my estimate by $500,000. Those fees have become so oppressive it seems there is nothing we do can overcome it; payment card fees are literally choking the air out of our business, and it is becoming increasingly difficult to run a business when I have no ability to predict increases in our second largest expense.

Nor do we have the ability to choose one type of card over another, because the banks that issue the cards all demand that we accept all cards within their portfolio. Unlike all of our other suppliers of goods and services, banks are not competing for our business. This stands in stark contrast to suppliers like Coke and Pepsi, as just one example. If we do not like the price Coke seeks for its fountain syrup, all I have to do is call up the Pepsi distributor. With this type of competition, we get a decent price. Most companies fight very hard to do business with our industry, allowing us to negotiate the very best deal for us and our consumers.

The fact that we do not get a competitive price for card fees is not due to a lack of trying. From 2007 to 2009, I was president of the national advisory council for marketers of a major oil company. With the strength of this player and the voice for more than 7,000 stores behind me, I certainly hoped to achieve enact degree of change on behalf of all of us. But what I learned was even the biggest of the big have no ability to negotiate with these financial entities. The best we got were marginal concessions on some processing fees that make up only a tiny part of the total fees we pay; and those concessions came at the oil company's expense. On interchange, which is the bulk of what we pay, Visa and Master Card refused to budge. I felt that if a company representing more than 7,000 stores could not make any headway in attempting to negotiate on interchange, it is unlikely that anyone can.

Worst of all, there are no other realistic options: our customers expect us to accept these cards, and all of our competitors accept them, so we do not get more business by accepting cards – there simply is no business without accepting cards. Visa and MasterCard are another form of currency and we must take them like we must take cash. Indeed, approximately 80% of ShortStop's sales are paid by credit and debit cards, and we expect that percentage to increase as more young people patronize our stores. At this volume, we can pay reasonable fees for interchange and processing, and it is not my position, or that of NACS, that card processing should be free. What I and other convenience stores cannot continue to do, however, is pay exorbitant fees to subsidize card programs like travel rewards, and absorb the costs of the poor credit risks that issuers have been all too willing to take on.

Policymakers truly need to begin to see payment cards as a new form of currency, because at 80% of sales and growing, that is what payment cards have become and will be in the future. If the U.S. Treasury decided to offer a reward or a perk to everyone who obtained cash from a bank, there would be no question that taxpayers would not support such a system. And checks are cleared at par, not par plus a reward. So while I do not have a problem with paying a fee to process card transactions, I believe we have reached the point that the process of determining that fee cannot be left solely to the whims of the people sitting in the board rooms of the credit card companies.

In sum, the increases that I am seeing in credit and debit card fees are simply unsustainable. The amount I paid in card fees last year was considerably more than I pay on my entire debt service on my investment capital in the business. If interchange fees were half of what they currently are, I could support significant additional investment capital that I could use to open more stores and provide more jobs in my community. With lower interchange fees, I could also lower prices. And lower prices mean more sales. Accordingly, I support efforts to rein in interchange fees.

The Significance of Interchange Fees for Community Banks

With assets exceeding $1 billion and 30 locations, Liberty Bank Iowa is at the larger end of the spectrum of community banks size-wise. We issue our own Visa branded credit and debit cards rather than outsourcing the payment card operation, although the operation is very costly to run. In 2009, the amount of revenue the bank earned on interchange accounted for less than 1%

of the bank's total revenue. The amount of profit that interchange accounted for was zero. Last year was a typical year, meaning that our bank views this as a breakeven operation at best.

The reason we issue Visa payment cards is purely for the convenience for our business customers, who appreciate the ability to have "one-stop-shopping" when it comes to their financial needs. At one time we outsourced our card operations and the financial results were no better. We received a fee for each new account opened (we received no interchange or other fees), which was barely enough to offset the expense of outsourcing. In the meantime, our customers were unhappy with the service provided by the firm that handled the operation for us; this outsourced operation was not good for our brand. For these reasons, Liberty Bank Iowa took its card operation back in house.

My understanding is that ours is a typical experience for large community banks. Liberty Bank Iowa has several locations, a Marketing Department, a solid customer base, and the resources to make the credit card operation as successful as possible. If Liberty Bank Iowa does not make money on issuing cards, it is difficult to see how smaller community banks with fewer resources would have any different experience. It is my understanding that many smaller banks outsource card issuance, a model likely to yield little or no profit based on our experience.

In sum, Liberty Bank Iowa is in the card issuing business solely as an added service for customers. Interchange fees have little significance for us in terms of revenue or profit, and I understand the same to be the case for most other community banks. Therefore, I disagree with the contention that efforts to bring interchange fees under control will harm community banks. This is simply not an item that is significant to the business of community banks.

In fact, changes to the system might help. Right now, we compete with other banks for customers on the basis of price and service. But there is no price competition on interchange fees. If there were, we might have more ways to attract customers and increase this part of our business. But the way it is, the huge banks make big money on interchange and market heavily to our customers through direct mail and otherwise. Liberty Bank Iowa has not been able to effectively compete with that, given that part of the competitive playing field is closed.

It is important to note here that there is no other aspect of our bank's operation in which we charge the same set of default fees or prices as all of our competitors. We compete on savings account rates, checking account rates, lending rates, account fees, and everything else that we charge. I don't understand why we're allowed to agree to charge the same thing on interchange as every other bank. It just doesn't make sense. I am an entrepreneur and believe in free markets. And what I know is this: legal or not, the interchange market isn't free. It is rigged to guarantee big money for the largest banking institutions, leave banks like mine the leftovers from their feast (at best), and tighten the noose on businesses like ShortStop as much as they can without killing us (though sometimes it proves fatal).

Conclusion

I am fortunate to be able to serve my community in Iowa as a both a retailer and a community banker. I see the effects of card swipe fees from both of those perspectives. I believe these fees are out of control, that they must be addressed so that small businesses like convenience stores can thrive, and that this can be done without doing any harm to community banks' business model.

Mr. CONYERS. Thank you, Dave Carpenter.

Ed Mierzwinski is a long-time witness before us, consumer advocate associated with the Public Interest Research Group, PIRG, has received some awards for his advocacy.

And we welcome you here again.

TESTIMONY OF EDMUND MIERZWINSKI, CONSUMER PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you. Thank you again, Chairman Conyers, Mr. Smith, Members of the Committee. It is a privilege to testify before you on this important matter.

The matter of credit card interchange fees is a very important one for consumers. Because merchants can't negotiate these fees all consumers pay more at the store and more at the pump, even if they pay with cash at the store.

Further, the subsidy runs in the wrong direction. Interchange fees are used by the issuing banks to pay for rewards. My miles, my dollars, my other kinds of points that I receive are paid for by the cash customers, many of whom can't afford credit cards or even bank accounts. So the market is broken.

The courts have found that Visa and MasterCard have market power. They have the ability to set prices. That is wrong.

That is why creating a method of collective bargaining that will help merchants to negotiate with the banks could lower the fees, and we believe, as Mr. Carpenter said, that because the retail market is competitive, that those fees will be—result in lower prices for consumers, that the savings will be passed along. Retail is so competitive for all the studies that I have seen that I believe that that would be the result. And we will certainly, as consumer advocates, monitor if that is the result.

I am very troubled, when I talk to merchants about these issues, that they are prevented by the rules—now, the industry will tell you that the rules do not prevent this, but the merchants actual problems with the rules defy what the banks tell you, and that is that they are prohibited by the rules from telling consumers they can have a better deal if they offer a lower-price payment mechanism, as Mr. Welch's bill would provide for.

They are threatened with thousands of dollars a day in penalties if they challenge any of the contract rules that Visa and MasterCard impose on them. So I don't like the fact that the banks have that much power that they can threaten the merchants.

The kinds of problems that extend in this market, as you noted, also extend to the issuance market. The power that the banks have—the biggest credit card companies have—over the marketplace allows them to impose unfair practices on consumers as well, and those unfair practices were limited by Representative Maloney's credit card act, the Credit Card Bill of Rights, that the President signed just almost a year ago now, May 2009, but in order to protect consumers and merchants I think we need a strong agency to enforce that new law.

We certainly can't in any way rely on the current bank regulators—the regulators who supposedly surveilled over the system that failed and allowed the credit card companies to get out of control. We need a strong consumer financial protection agency, one with the power to enforce rules over the banks and over the credit card companies and to make the system work for consumers.

I think we also need to reinstate consumer private rights of action to enforce the law. The merchants are trying to take the credit card companies to court. In some cases they have been successful.

But it is very difficult for a consumer to take a credit card company to court, and that is partly because of the unfair forced arbitration clauses that are included in consumer credit card contracts. While the CFPA would be given the authority to ban those arbitration provisions in both the House version and, in a weaker way, the other body's version of the CFPA, we would prefer that the bill sponsored by your Committee, the American—I am sorry, the Arbitration Fairness Act, by Hank Johnson, and you, and 110 other Members of Congress—is the better way to go to ban arbitration.

One point that I want to make that is not in my testimony, the—in detail, a couple of years ago plastic transactions passed cash transactions, and I am astonished to hear that in fact, in retail convenience stores, plastic is 80 percent—I had thought it was somewhere around 55 or 60 percent of transactions.

But it is going to even get worse because the banks are switching and trying to substitute government payment mechanisms onto prepaid debit cards, so they are trying to use their market power to get the lowest-income Americans to use debit cards to receive their government benefits. That is going to make things even worse.

Again, it is going to result in a system where prices in the stores go up, the banks have too much power. So we support your bill and urge you to pass it.

Thank you.

[The prepared statement of Mr. Mierzwinski follows:]

PREPARED STATEMENT OF EDMUND MIERZWINSKI

Testimony of Edmund Mierzwinski
Consumer Program Director
U.S. PIRG
Before the House Judiciary Committee
Hearing on HR 2695, the Credit Card Fair Fee Act of 2009
28 April 2010

Chairman Conyers and Ranking Member Smith, thank you for the privilege of testifying today on the important subject of credit card interchange fees. I am Consumer Program Director of the U.S. Public Interest Research Group, the nonpartisan and nonprofit federation of state PIRGs.[1] As an advocate for consumers we welcome the opportunity to discuss the introduction of HR 2695, the Credit Card Fair Fee Act of 2009 (Conyers), your legislation to address antitrust concerns regarding interchange fees imposed on merchants by credit card networks. We welcome the committee's continued attention to credit card interchange rates. As you know, over 25 years ago, Supreme Court Justice Marshall spoke of the importance of the antitrust laws as the "magna carta of economic freedom." Thus, the vigilance of the Committee in assuring the aggressive enforcement of the antitrust laws is important to every U.S. consumer.

A primary purpose of my organization is to advocate on behalf of all consumers for a fair and competitive marketplace. We regularly advocate before state and federal regulators and legislators on both consumer protection and competition policy issues in the credit card marketplace.[2] We have also launched a major campaign on over 40 college campuses around the country against unfair credit card marketing practices.[3] We recognize that financial service markets work best where there is vigorous competition protected from anticompetitive practices. The work of your Committee in overseeing enforcement of the antitrust laws plays a vital role for this important marketplace.

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[1] The United States Public Interest Research Group (U.S. PIRG) serves as the federation of and the federal lobbying office for the state PIRGs. State PIRGs are non-profit, non-partisan consumer, public health and good government watchdog groups with over one million members around the United States. U.S. PIRG places a special emphasis on predatory financial practices and financial education and maintains a website at www.truthaboutcredit.org for consumers to obtain non-partisan information and fact sheets about credit card company practices. Recent major PIRG reports on credit card practices include the following: Characteristics of Fair Campus Credit Cards (April 2008); The Campus Credit Card Trap: A Survey of College Students and Credit Card Marketing (March 2008); Graduating Into Debt: A Survey of On-Campus Credit Card Marketing In Maryland (2004); Deflate Your Rate: How To Lower Your Credit Card APR (2002) and The Credit Card Trap: How To Spot It, How To Avoid It (2001). www.uspirg.org or www.truthaboutcredit.org.

[2] For example, see my recent testimony before the Financial Services Committee, on interchange fees (8 October 2009), available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/fchrCC_100809.shtml; on financial regulatory reform (16 July 2009) available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/fchr_071809.shtml and on consumer financial protection (24 June 2009) available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/hrfc_062409.shtml. Also, on whether unfair consumer credit card practices lead to bankruptcy before this committee's Subcommittee on Commercial and Administrative Law on bankruptcy and credit card debt (2 April 2009), available at http://judiciary.house.gov/hearings/hear_090402_1.html. I have also testified in previous Congresses before this committee and its Antitrust Task Force on interchange reform.

[3] See "http://www.truthaboutcredit.org

SUMMARY:

For the past three years I have testified before this Committee and presented a simple message: the deceptive and anticompetitive practices of the two credit card associations – Visa and MasterCard – have injured both consumers and merchants for many years. That message still rings true. Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers subsidize credit card usage by paying inflated prices for many goods and services. These prices are inflated by the billions of dollars of anticompetitive interchange fees, which are used to subsdize rewards programs, promotions, and riskier credit underwriting for credit card users. And unfortunately, those credit card interchange fees continue to accelerate, because there is nothing to restrain Visa and MasterCard from charging consumers and merchants more.

Your legislation, HR 2695, the Credit Card Fair Fee Act of 2009, would address the problem by creating a mechanism to enable merchants to negotiate with Visa and MasterCard and compel the card associations to engage in those negotiations. It provides a framework, adapted from the Copyright Tribunal, to facilitate negotiations and resolutions of disputes. When negotiations fail, your bill builds on existing models to require proposals from both sides to a special panel. The panel does not set prices or establish government price controls, as bank propaganda asserts; instead, it evaluates the two proposals based on what prices would be in a competitive market. The way that the bill is structured, there is pressure on both the merchants and issuers to come to an agreement—otherwise the panel picks one or the other of their proposals. These are positive outcomes.

The opponents of the legislation may suggest that consumers will be harmed from the enactment of the legislation because banks will not longer be able to provide allegedly attractive rewards programs. Even if that is true – and it is not – that should not drive the Committee's evaluation of the legislation. Rewards programs are not a "free gift" given by banks. Rather, <u>all</u> consumers pay for rewards in the form of higher prices for the goods they purchase everyday. Indeed, card issuers actually account for reward programs in their public financials as reductions in interchange income. Only a small portion of <u>cardholders</u> actually receive rewards and the portion they receive is very modest compared to what cardholders pay in interchange. But most important, the most vulnerable consumers, those without credit cards, receive nothing from interchange, and subsidize the supposedly "free gift" of rewards programs for more affluent consumers.

Because interchange fees subsidize riskier underwriting practices by credit card issuers, credit cards have ended up in the hands of less creditworthy consumers. Banks have an incentive to encourage more and more people to use credit cards because every charge results in an interchange fee. Card issuers pushed this too far and declining underwriting standards have resulted in some card issuers needing to be bailed out by taxpayers.

None of the alternatives to legislation is particularly likely to resolve the fundamental competitive concerns in this market. The rapidly accelerating interchange fees appear to be a clear exercise of market power by Visa and MasterCard. In the past year alone the total amount

of interchange fees collected has reached $48 billion after years of constant increases. This is a staggering number given the fact that retail sales have suffered as a result of the recession. Did consumers benefit from this rapid increase? Did cash customers benefit? Obviously not. Did credit card customers benefit? Did rewards programs improve substantially? Were there greater benefits to cardholders in some fashion? We doubt it.

Discussion

Based on our experience in these and other markets we believe there are two essential elements to a competitive marketplace: information and choice. Accurate and transparent information is necessary for consumers to make accurate choices. When information is readily available consumers can make choices, effectively compelling firms to compete for their purchases. And choice is a necessary element too. Absent choice, the discipline of the market will be lost.

The credit card market lacks both choice and adequate information. From a consumer's perspective it lacks choice because it is an oligopolistic market in which a small set of card-issuers dominate the market and establish a set of deceptive practices that harm consumers. From a merchant's perspective it lacks choice because merchants have no alternative but to accept the card associations' cards even when the associations significantly increase prices.

Markets don't work when there are hidden fees and rules – and no one hides fees and rules better than the credit card companies. Credit card markets lack the information necessary for both consumers and merchants to make informed choices. The markets lack adequate information for consumers to detect the fraudulent and exploitative practices of many card-issuers. For merchants, the markets lack adequate information because the associations prevent merchants from accurately informing consumers of the costs of credit card acceptance or attempting to direct them to more efficient and lower priced payment mechanisms. Moreover, the banks and associations engage in other deceptive practices to increase the interchange problem. Since the costs of accepting cards are passed on in the overall costs of goods, all consumers – affluent, working-class, and poor – ultimately pay these hidden charges. Low-income Americans, most without bank affiliations, are paying more for goods and services to fund credit card company programs for which they are not even eligible.

Interchange and Its Effects

We present six main points:

- All consumers, even those who pay with cash and checks, pay more at the store and more at the pump because these interchange fees are passed on in the overall cost of goods sold.
- The significant increases in interchange fees signal a broken market. Visa and MasterCard have tremendous market power, which allows them to dictate the terms of trade: merchants have no choice but to accept Visa and MasterCard products on the sellers' terms. It is not surprising that interchange fees have increased significantly and are much higher in the U.S. than other countries.

- The card associations' rules prevent merchants from informing consumers on the costs of payment and limit the ability of merchants to direct consumers to the safest, lowest cost, and most efficient forms of payment.
- In addition, both the associations and banks engage in a variety of deceptive practices to drive consumers to higher-cost forms of payment.
- Neither the card-issuance or card network markets are competitive. Because of lax merger policy the card-issuance market has become an oligopoly. Ten banks account for approximately 90% of the issuance market. Interchange and consumer fees have increased as concentration has increased to alarming levels.
- Finally, this oligopolistic concentration has allowed issuers to engage in a variety of unfair and anti-consumer practices.

Interchange Fees Force Consumers to Pay Higher Prices

The interchange fee system is hidden from consumers and the public. The card associations do not disclose publicly their fees or the basis for these fees. Some public reports maintain that, on average, interchange fees cost merchants 2.0 percent or more of each transaction on a credit or signature debit card. In 2009, credit card interchange fees alone cost merchants and consumers an estimated $48 billion.[4]

Like all other costs incurred by merchants, interchange fees are included – at least in part – when pricing goods and services. Card associations may suggest that interchange fees fund attractive rewards programs. Setting aside the question of the dubious value of these programs, many consumers with credit cards do not use them and those without credit cards receive no benefits.[5] Over 27 percent of Americans do not have credit cards. For these consumers, interchange fees are especially pernicious and regressive.[6] These low-income Americans subsidize interchange fees for "services" that they are not eligible to use. No charge could be as regressive as one in which low-income consumers receive no benefits.

The Hispanic Institute, an organization that educates Hispanic Americans on a number of issues, released a report last November titled "Trickle-Up Wealth Transfer: Cross-subsidization in the payment card market" that details the findings of a study the Institute conducted on American consumers. They found that those Americans who do not benefit from credit card rewards pay in excess of $1 billion annually to subsidize those awards, which typically accrue to higher-income consumers, as a result of the higher prices consumers pay because of interchange fees.[7] This imbalance makes it clear that interchange fees are no friend to the vast majority of consumers. In

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[4] Foer, Bert. "Our $48 Billion Credit Card Bill." New York Times. April 20, 2010.

[5] We seriously doubt consumers receive anything close to $42 billion in benefits through rewards programs. Some of the interchange fees undoubtedly fund industry marketing efforts, such as the more than 5 billion annual mail solicitations consumers receive for credit cards. Moreover, credit card issuance is a tremendously profitable line of business. According to the Federal Reserve, it is consistently the most profitable line of banking.

[6] U.S. Census Bureau, *Statistical Abstract 2006*, Table 1176.

[7] In a recent study, the GAO also cites this issue: "Consumers who do not use credit cards may be worse off by paying higher prices for goods and services." Government Accountability Office. "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges." November 2009.

the report, the Hispanic Institute recommends policies or regulatory actions to remedy this tax on low-income consumers, including those that would lower interchange fees and thus reduce the wealth transfer that occurs as a result of the higher costs card issuers pass on to all consumers.[8]

The regressive nature of this charge is exacerbated because interchange fees are assessed as a proportion of overall sales. For example, when gas prices averaged $1.87 per gallon in 2004, interchange fees totaled about $12.5 million per day. In 2005, gas prices averaged about $2.75 per gallon nationally: credit card companies then made $18.4 million a day. These companies made an additional $2.2 billion dollars per year simply because of rising gas prices.[9] This problem will increase if gas prices continue to increase. It is difficult enough for low- and moderate-income consumers to afford skyrocketing gasoline prices without having to pay additional fees that are passed on to them.

Increases in Interchange Fees Signal a Broken Market

Credit card interchange fees were intended to compensate card-issuers for certain costs, such as the costs of issuance, fraud, risk of loss, float and processing. Yet as all these costs have decreased in the past decade credit card interchange fees have increased. According to the Food Marketing Institute (FMI), these fees have increased over 20 percent in the past few years even though all the costs of card processing and issuance have fallen. The United States appears to be the only country in which credit card interchange fees are increasing and it has far higher fees that almost any other industrialized country. FMI projects that these fees will increase 22 percent annually.[10]

In a competitive market, prices would fall when costs decrease. In the credit card market, the opposite happens. The card associations may say that they need to increase interchange fees to compete for the loyalty of card issuers. But what about merchants and consumers? Merchants certainly have no choice but to accept Visa or MasterCards.

In the recent Department of Justice antitrust litigation against Visa and MasterCard, the Second Circuit Court of Appeals determined that both associations had market power because merchants were compelled to accept these cards even in the face of a significant price increase. Almost all merchants are forced to accept Visa and MasterCard's terms, no matter what the interchange rates or contractual terms. Armed with this market power, credit card companies can, and do, increase interchange fees without suffering any repercussions.[11]

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[8] The Hispanic Institute. "Trickle-Up Wealth Transfer: Cross-subsidization in the payment card market." November 2009. http://www.thehispanicinstitute.net/files/u2/Trickle-Up_Wealth_Transfer_Paper.pdf

[9] Margaret Webb Pressler, "Card Companies Are Filling Up at the Station," in Washington Post. September 25, 2005: pg. F01.

[10] Food Marketing Institute, "Hidden Credit Card Fees: The True Cost of a Plastic Marketplace" (February, 2006).

[11] A recent GAO report reads, "Our own analysis of Visa and MasterCard interchange rate schedules shows that the interchange rates for credit cards have been increasing and their structures have become more complex, as hundreds of different interchange fee rate categories for accepting credit cards now exist." Government Accountability Office. "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges." November 2009.

Are these substantial interchange fees necessary? Examples outside the United States suggest this is not the case. As a recent European Commission decision detailed, numerous countries operate payment systems without the use of interchange fees. In those countries the ultimate costs of these systems is modest and the systems operate quite efficiently. In an effort to head off the European Commission's antitrust proceedings against them, Visa Europe recently announced that they would be slashing transaction fees on debit cards by fully 60%, down to just 0.2% – a small fraction of the interchange fees here, and a clear sign that the fees here are artificially inflated. Visa Europe certainly isn't cutting rates below what it will cost them to remain profitable.[12]

Another example is the debit market in Canada. In that market, there are no interchange fees. Even without interchange, there is higher debit card usage and merchant acceptance than in the United States. Some consumers pay direct fees for debit card use but because those fees are transparent there is active competition to reduce those fees. Ultimately everyone in Canada pays less for the cost of payment services.[13]

New Zealand has also taken action to reduce interchange fees and enhance competition between credit card issuers. The country's Commerce Commission ultimately settled with both Visa and Mastercard to set maximum allowable interchange fees, imposing caps at 2% or lower for all categories of purchases.[14]

There is a great deal of debate about the impact of reductions in interchange fees in Australia, but a careful, neutral analysis of that debate demonstrates that the reduction in interchange fees ultimately benefited consumers in the reduction of card costs, greater innovation, and greater competition leading to lower interest rates. Several years ago the government mandated a reduction in interchange fees in Australia from 0.95 to 0.55 percent (both rates far lower than the current rates in the U.S.) It was recently reported that fees to merchants were 1.1 billion Australian dollars lower from March 2007 to February 2008 as a result.[15]Reducing interchange has also spurred innovation, leading the card issuers to offer new types of cards such as no-frill cards with lower fees and lower interest rates. The Federal Reserve Bank of Australia found an overall benefit to society because consumers received better pricing signals, creating an incentive for them to use the most efficient forms of payment.

While a study funded by MasterCard found no benefit to consumers from the reduction of interchange fees in Australia, the Federal Reserve Bank of Australia vigorously disputes this finding.

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[12] PaymentsSource. "Bulletin: Visa Europe Agrees To Cap Intra-regional Debit Interchange Rate." April 26, 2010.

[13] Gordon Schnell and Jeffrey Shinder, "The Great Canadian Debit Debate." *Credit Card Management*, May 2004. http://www.constantinecannon.com/pdf_etc/TheGreatCanadianDebit.pdf

[14] See "Visa New Zealand Domestic Maximum Interchange Reimbursement Fees," http://www.visa-asia.com/ap/nz/mediacenter/factsheets/interchange.shtml and "Interchange Fees: MasterCasd Domestic Purchase Transactions Interchange Fees for New Zealand," http://www.mastercard.com/nz/merchant/en/interchangefees/index.html

[15] Government Accountability Office. "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges." November 2009.

As the members of the Committee recognize, interchange, like any other credit card policy, affects different groups of consumers differently. In fact one of the strongest reasons for attacking the interchange fee problem is that the costs of interchange are borne by all consumers: thus, cash paying customers, many of whom are not eligible for credit cards, effectively subsidize the attractive rewards programs for far more affluent consumers. In considering efforts to solve the interchange fee problem, protecting these consumers must be the first priority of this Committee.

The evidence from Australia seems relatively clear: cash paying customers benefit from the reduction in interchange:

> The Board acknowledges that the reforms have not affected all parties equally. In particular, those who use EFTPOS and cash are more likely to have been made better off as a result of the reforms than those who use credit cards extensively and pay their balances off by the due date. Previously, this latter group was receiving significant benefits, partly at the expense of the former.[16]

For those individuals holding credit cards, there are general benefits in lower interest rates and card fees. And for transactors (those who pay off their balance on time) there was a slight decrease in benefits, as rewards programs have been reduced, but these programs only benefit some users. In the United States, where interchange fees are considerably higher, the potential savings for each consumer could be far greater.

The opponents of a competitive interchange fee market may suggest that any reduction in interchange fees must result in an increase in other fees such as annual fees or late fees. This argument overstates any legitimate concern. A reduction in interchange fees will only result in an increase in other fees to the extent that the credit card market is not competitive. If the market is in fact competitive, it will instead result in banks striving for greater efficiency by reducing their costs or by simply having reduced profit margins. Cost cutting could come in a reduction of the blizzard of promotional mailings sent out by banks on a daily basis. It could also come from a reduction in rewards programs. To the extent that rewards programs are scaled back, however, it will mean that banks must compete in terms of interest rates and other fees, thereby benefiting consumers. In the U.S., lower interest rates are the most important criteria for most consumers to use when determining their choice of cards and reform that improves those rates will be an important consumer benefit, even if there is some reduction of rewards programs.

Deceptive Practices Increase Prices for Consumers

As we suggested earlier, accurate and complete information serves a critical role in making sure the forces of competition work. As the government does not regulate or compel disclosure of credit card interchange fees, most consumers have no idea that they exist and that they are paying for services that they may not even use. In fact, Visa, MasterCard and the card issuing

[16] Reserve Bank of Australia, Reform of Australia's Payment System: Preliminary Conclusions of the 2007/08 Review (April 2008).

banks engage in a variety of practices to prevent well-informed consumers from exercising their choices.

First, Visa and MasterCard rules prevent merchants from disclosing fees to their customers or attempting to steer consumers to lower-priced payment options, such as cash or online debit cards. They cannot charge a distinctive price or surcharge based on payment options. They cannot attempt to direct consumers to lower priced credit cards or to other cheaper payment systems such as cash, checks and online debit.[17]

Second, card associations and banks use misleading marketing to encourage consumers to use their credit cards or signature debit cards as frequently as possible. Reward incentives, such as frequent flier miles, are designed to seem as though customers are paid to use these cards. In reality, these consumers and other consumers are simply paying for those rewards.

This lack of disclosure is especially problematic with the efforts of the card associations to "convert" cardholders from regular credit cards to so-called "premium cards" such as the Visa "Signature" or the MasterCard "World" cards. These cards have a significantly higher interchange fee than traditional cards, among the highest of all interchange fees. For example, a premium card may cost merchants well over 2.0 percent compared to 1.6 percent for a traditional card. These premium cards focus only on the highest-income consumers. However, they offer minimal additional benefits. Consumers do not realize that everyone else pays higher prices on goods and services when they themselves use a premium card and consumers are wholly unaware that converting to a premium card will ultimately cost all consumers more. Nor, as stated above, can merchants refuse to accept these cards or attempt to direct consumers to lower priced cards through differential pricing. These premium cards are simply a scheme to substantially increase hidden interchange fees.

Third, although merchants can't surcharge or use differential prices to direct consumers to the most efficient and lowest priced payment options, banks do have that power. Not surprisingly, they use it to direct consumers to less efficient, higher cost options. The debit card market illustrates this problem. Signature based debit is more expensive and less secure than online debit because online debit transactions are instantaneous. Online debit has a far lower rate of fraud. Online debit transaction interchange fees are capped at fixed levels; they only cost merchants between \$0.17 and \$0.50 per transaction.[18] Conversely, credit and signature debit cards cost merchants up to 2% of the entire transaction, no matter how large. Instead of promoting online debit which is safer and less costly, banks increasingly surcharge consumers

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[17] We note that the standard canned industry response is that "nothing in our rules prevents cash discounts from being offered." This argument is both irrelevant and only technically correct. For a merchant that wishes to accept credit cards, but does nto want to accept high-cost premium cards, the ability to offer a cash discount is irrelevant. And for merchants that wish to steer customers to other payment options, the ability to cash discount (from federal and state law) is rendered largely useless by card association regulations that require separate price markings for each product with the higher interchange price and the lower cash price makes cash discounts very hard to offer. Fuel is a relatively simple example, but even there with a variety of different octane grades and products (gasoline, diesel, etc.) card association rules can make discounting more difficult than it ought to be. And if it is difficult for fuel, imagine the logistical difficulties created for offering cash discounts at a convenience store with a thousand different items, let alone a grocery store with thousands of different items for sale. The card associations may not technically prohibit cash discounts, but they do what they can to make sure it does not happen very often.

[18] November 2004, Federal Reserve Board, Report to the Congress on Disclosure of Point-of-Sale Debit Card Fees, See Figure 4, page 14 available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf.

seeking to make these transactions with penalty fees of as much as 50 cents a transaction.[19] Consumers are paying more for a less safe and more costly product.[20] These penalties effectively steer consumers to the less efficient, less secure, more costly signature debit product. While the use of online debit cards is the best option for both consumers and merchants, deceptive and manipulative tactics ensure the most expensive payment possible is used.

These examples show that card associations and banks use some of the same deceptive practices against merchants as we have seen them use against consumers for years. Not only do the merchants suffer as a result, but consumers, unwittingly, do too.

Not surprisingly, outside the United States, where these anticompetitive practices are not permissible, online debit is the most preferred form of debit. Online debit is a far safer and more secure product, with a much lower incidence of identity theft than signature debit or credit cards. Where market forces are not restrained and consumers can make fully informed choices, the lower-priced, more efficient product prevails.

The Potential Impact of the Proposed Legislation

The legislation you have sponsored Mr. Chairman, H.R. 2695, the Credit Card Fair Fee Act, addresses the interchange fee problem by creating a structure for the voluntary negotiation of interchange fees and, if agreement can not be reached, for the resolution of disputes about the amount of the fees. The Act, modeled in part after the Copyright Royalty Tribunal, provides a mechanism for resolution of interchange fee disputes. We believe this would be a useful approach to addressing the concerns of the market power of the card associations and rapidly increasing interchange fees.

We believe there are three important considerations for the legislation:

- First, this is a non-regulatory approach. The legislation envisions a system of negotiation and resolution which focuses on private parties reaching an agreement, rather than a government mandated solution
- Second, if the parties are unable to reach an agreement, the tribunal hearing the dispute must apply a market standard in choosing the appropriate fee level – in this respect the proposal envisions that the tribunal would not set prices, but would only have the power to chose which of the final offers of the parties most

[19] A 2003 NYPIRG report found that 89% of the banks surveyed assess a fee for online debit PIN-based transactions. The average fee assessed is 70¢. The fees ranged from 10¢ to $1.50. See "Pricey Plastic: A NYPIRG Report and Survey of Plastic Card Fees," 2003, available at http://www.nypirg.org/consumer/cards/debit.html (last visited 18 July 2007). While a Federal Reserve study found substantially lower numbers of banks imposing PIN debit fees, it found fees in the same range: "At sampled institutions that charge fees for PIN debit, the fees range from roughly $0.10 to $2.00 per transaction (figure 5). The median (and mean) fee is approximately $0.75." See "Report to the Congress on the Disclosure of Point-of-Sale Debit Fees," November 2004, Federal Reserve Board of Governors, available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf

[20] All plastic is not created equal. Congress should also upgrade the weak consumer and anti-fraud protections applicable to debit, ATM and stored value cards (regulated under the Electronic Fund Transfer Act and Regulation D) to the higher standard credit cards are subject to (that of the Truth In Lending Act and Regulation Z). But within the debit card universe, PIN-based online transactions are more secure than offline signature based transactions.

closely represents the rates and terms that would have been negotiated in a competitive market.

- Finally, market based rates and terms are available to any merchant regardless of size, industry or location.

We believe the proposed legislation offers some promise of remedying the competitive problems posed by interchange fees. It seems highly unlikely that either Visa or MasterCard's market power will be diminished significantly in the foreseeable future. The legislation presents an opportunity to create a market-oriented approach to remedying Visa and MasterCard's ability to exercise their market power by charging anticompetitive interchange fees.

Increased Consolidation of Card-issuers Harms Consumers More Broadly

The credit card issuing market has become significantly more concentrated over the past few years as numerous card issuers have merged. For example in the past few years we have seen mega-mergers such as Bank of America's acquisitions of Fleet and MBNA. The top ten card issuers now have over 90% of the market, and the level of concentration has increased from an HHI of about 1100 in 1998 to an HHI of over 1800 today, a level that the Department of Justice Merger Guidelines define as highly concentrated. Unfortunately the Department of Justice has not challenged any of these mergers and there is little to suggest that concentration in this market will not continue to increase dramatically.

Of course, we expect the card associations and their members to suggest that the credit card issuance market is un-concentrated and vigorously competitive.[21] But the facts are to the contrary. There have been numerous antitrust suits alleging that card issuers and the associations have colluded over fees, exchange rates, and important contractual terms.[22] While concentration has increased dramatically over the past seven years, interchange fees, other fees charged to consumers, deceptive practices, and interest rates have increased significantly. Although the parties to these mergers suggested that there would be significant efficiencies from these mergers, consumers have seen few, if any, benefits. After years of consolidation the bad news for consumers is clear: an oligopolistic market which is a fertile environment for collusion, higher prices, more hidden fees, and more deceptive practices.

Congress has taken on financial reform as a response to the laundry list of reckless practices in financial markets. The very existence of interchange fees explains the perverse incentives that may have encouraged card-issuing banks to engage in indiscriminate lending rather than curb

[21] In testimony in 2005 Timothy Muris testified that "[n]o [card] issuer has market power, and issuers respond to increases in interchange fees by enhancing card benefits to consumers." We doubt that Visa and MasterCard or card-issuers act as benevolent monopolists, but in any case there is no systematic study to suggest that increased interchange is passed on to consumers in greater benefits. Even if this allegation was substantiated, it would still be true that all consumers, including those who do not use credit cards pay for those "increased benefits."

[22] In 2006, Visa, MasterCard and several card-issuing banks settled an antitrust suit for $336 million alleging they had fixed the credit card foreign currency exchange rates. Other litigation involves alleged collusion by card-issuers over credit card late fees and over limit fees (In re Late Fee and Over Limit Fee Litigation, Civ. No. C-07-0634 SBA (N.D. Cal.)) and alleged collusion by card-issuers and networks requiring the use of mandatory arbitration provisions (Ross v. Bank of America, N.A. et. al. Civ. No. 05-07116 (S.D.N.Y.)).

credit risk. Banks and the card companies profit from these fees regardless of the consumer's ultimate ability to fulfill their debt obligations, and thus have an immediate incentive to issue cards and encourage a high volume of transactions.[23] This undermines the safety and soundness of the entire financial system.

The Credit Card Oligopoly Also Allows Issuers to Use Anti-Consumer Practices Against Cardholders

Last May, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act, which addresses a number of deceptive practices credit card companies regularly engage in at a high cost to consumers. The Credit Card Fair Fee Act is a necessary complement to these provisions, which ban credit card companies from a number of practices. Major components of the legislation include:

- Banning credit card companies from imposing arbitrary and unfair interest rate increases and changes in terms
- Prohibiting a range of exorbitant and unnecessary fees
- Requiring fairness in application and timing of card payments
- Requiring reasonable disclosure of card terms and conditions

There is no question, of course, that the current bank regulators will not adequately enforce the new law. We also need to enact a strong independent Consumer Financial Protection Agency and restore the right of states to enact stronger consumer laws and the right of their Attorneys General to enforce both federal and state laws against both state and nationally-chartered banks. We also need to restore full private rights of action to enforce laws. Encouragingly, the House-passed version of Wall Street reform, HR 4173, gives the CFPA broad authority to ban forced mandatory arbitration clauses that limit consumer rights to enforce the law; the Senate proposal, which may come to the floor this week, includes a more modest provision. We would prefer enactment of the Arbitration Fairness Act, HR 1020, sponsored by Rep. Hank Johnson, Chairman Conyers and 110 other members, to simply ban all arbitration clauses in all consumer contracts.

The fact that credit card companies freely engaged in such a wide range of deceptive and unfair practices that resulted in higher costs to consumers without being wholly rejected by market forces suggests that Visa and MasterCard have simply enjoyed market power. The oligopolistic market structure of the card-issuance market facilitates these deceptive and onerous practices. The ability of these dominant card-issuers to impose these terms is derived from the tight oligopoly that the largest issuing firms maintain in the marketplace. We urge the Committee to examine closely the competition issues that allow this oligopoly to treat customers so unfairly. In particular, we urge you to question whether the Department of Justice, in approving every recent credit card company merger with no conditions, has adequately reviewed the competition implications of the mergers.

[23] Adam Levitin, Associate Professor of Law, Georgetown University Law Center. Testimony before the U.S. House of Representatives, Committee on the Judiciary, Subcommittee on Commercial and Administrative Law. Hearing: Consumer Debt – Are Credit Cards Bankrupting Americans? April 2, 2009.

There is a clear lack of competition in the card network market. Visa and MasterCard have the ability to prevent many of these practices through their regulation of card-issuers. Yet these associations -- which are aggressive in regulating merchants (e.g., preventing them from offering cash discounts) -- are timid when it comes to restricting the deceptive practices of their bank members. If there was active competition in the card network market one would expect Visa and MasterCard would compete in trying to self-regulate and stop these anticonsumer practices. Similarly, if there were not substantial entry barriers one might expect a more consumer friendly card network to arise. But the dominance of Visa and MasterCard and the substantial entry barriers effectively protect these deceptive and anticonsumer practices.

Conclusion

In the past some of the defenders of interchange fees have claimed that "[i]f consumers understood the threat that the merchants' campaign [against interchange] poses to the plastic in their wallets, I suspect that we would see nothing less than a revolt." this claim not have been more wrong. If consumers understood the existence or the dimensions of the hidden fees assessed by the banks and associations, they would truly rebel. Credit card companies make billions of dollars each year through interchange fees, which ultimately all consumers must pay, including the millions of Americans without credit cards. Low-income cash-paying customers subsidize an inflated rewards program that benefits only a small portion of cardholders. The credit card market lacks the critical foundations of healthy competition – choice and adequate information. As a consumer advocate, I am gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income.

We applaud you for recognizing the problem and proposing thoughtful legislation that offers the promise of remedying the interchange fee problem. Along with other consumer groups, we hope to work with you on this and other efforts to protect consumers from anticompetitive tactics in this vital market.

Thank you for considering this testimony. I welcome your questions.

Mr. CONYERS. John Blum, veteran, officer in the Army for many years, vice president of Federal Credit Union Chartway, in Virginia Beach, Virginia. He has been senior manager at Home Depot and Haynes Furniture, and now has a business with 55 branches in 10 states—200,000 members that he provides financial services to around the world, as a matter of fact.

We welcome you here to the hearing.

TESTIMONY OF JOHN BLUM, VICE PRESIDENT OF OPERATIONS, CHARTWAY FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF CREDIT UNIONS

Mr. BLUM. Thank you, Mr. Chairman, Ranking Member Smith, and Members of the Committee. My name is John Blum, and I am testifying on behalf of the National Association of Federal Credit Unions.

I do serve as vice president of operations at Chartway Federal Credit Union, in Virginia Beach, Virginia. We represent 200,000 members now, with over $1.5 billion in assets. We operate 55 branches in 10 states and provide financial services to those members across the globe.

My responsibilities at Chartway include the operational performance of our credit and debit card portfolios. The electronic payments system has proven to be one of the most important advances in the financial services marketplace in the last century.

Retailers reap tremendous benefits in the form of increased sales, reduced costs for overhead, and guaranteed payment for goods and services while the financial institution assumes the risk of nonpayment and fraudulent activity. This proposal would allow merchants to negotiate in an anticompetitive manner in order to shift their payment card acceptance cost to others.

While we appreciate allowing credit unions to opt out of the negotiated settlement mechanism in the bill, we find this language troublesome because it could create a system where plastic cards from credit unions are viewed differently by both merchants and consumers. It is with these concerns in mind that we pose a—we oppose the bill in its current form.

The current interchange fee structure allows credit unions to compete with the largest national banks. Credit union members know their card is substantially the same as what they would receive from a big bank and that it will work in all the same places. It is critical that credit unions continue to be able to compete in this market.

There are several fundamental misconceptions about the interchange fee system that need to be addressed. First, the interchange fee is not a hidden tax on consumers. Just like the cost of labor, electricity, gas, rent, or insurance, interchange fees are a cost of doing business.

Any increased revenue merchants earn as a result of paying lower fees for card services is unlikely to result in lower prices for consumers. If the Committee is intent on moving this legislation forward it should include provisions requiring merchants to pass any and all savings that they receive due to reduced rates on to consumers.

Second, the interchange fee is one of several costs associated with the final retail product, the merchant discount fee. This system is no different from any other retail product. For example, consumers do not get to negotiate the price their local diner paid for the eggs in their omelet even though being able to do so might result in a cheaper breakfast.

Interchange fees do not generate as much income as merchants would have you believe. Clearing a payment through the system is only one of the number of costs associated with issuing plastic cards and processing payments. The system does not simply run itself.

Chartway employs 11 people internally for debit card support, and we contract with a large service provider externally for credit card support. These substantial costs are necessary to ensure our debit and credit card portfolios are operating smoothly and that our members are satisfied with their service.

Interchange also helps offset the significant costs associated with direct fraud, which amounted to $8.6 billion in the U.S. last year. More ever, there are additional costs associated with each instance of fraud which are not captured by the statistics, nor are they covered by insurance.

Employees must contact and work with members to resolve problems, accounts need to be shut down, new account numbers and new cards need to be issued. In nearly every situation it is the financial institution that covers fraud losses—neither the customer nor the merchant share in the risk.

I find it particularly troubling that merchants are seeking to regulate my income even as I experience mounting fraud losses. If the Committee wants to help protect our Nation's consumers with this legislation I recommend adding provision that would hold those who fail to protect sensitive data responsible for the full cost of any losses that may occur as a result.

In conclusion, NAFCU strongly opposed H.R. 2695 in its current form. If mandatory negotiations force new caps on interchange fees they will enrich merchants while harming credit unions and consumers. Additionally, if credit unions opt out of this new service they may find themselves in a situation where their plastic cards are viewed as inferior.

The electronic payment system has proven incredibly beneficial to merchants. Retailers, however, want all of the benefits of the system while at the same time they are asking Congress to simply cut their cost of doing business.

As a businessman, I certainly understand why retailers would like to reduce their cost for processing transactions. As a consumer, however, I am weary of the government interfering with a valued product that has been incredibly successful, and which I use on a daily basis.

Finally, lowering interchange fees are unlikely to be translated into cheaper prices for consumer. The one thing that is clear, that the passage of H.R. 2695 in its current form will hurt credit unions and their 92 million members.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Blum follows:]

PREPARED STATEMENT OF JOHN BLUM

NAFCU

Testimony of

John Blum
Vice President of Operations, Chartway Federal Credit Union

on Behalf of

The National Association of Federal Credit Unions

H.R. 2695, the "Credit Card Fair Fee Act of 2009"

Before the

House Judiciary Committee

United States House of Representatives

April 28, 2010

Introduction

My name is John Blum and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the Vice President of Operations for Chartway Federal Credit Union, headquartered in Virginia Beach, Virginia. Chartway FCU was founded in 1959 by seven civilian employees of Norfolk Naval Air Base. Since then, Chartway has grown substantially and we now have more than $1.5 billion in assets and operate 55 branch locations in 10 states. Chartway serves over 200,000 members and provides financial services to our members across the globe.

For the past eight years, my responsibilities at Chartway FCU have included the operational performance of our credit and debit card portfolios. This includes card issuance, card activation, transaction authorization and processing, reversals, as well as funds verification, settlement, fraud/compromise analysis, and fraud protection of member funds. Prior to joining Chartway, I spent ten years in senior management positions for two big box retailers, The Home Depot and Haynes Furniture, preceded by thirteen years as an officer in the United States Army.

I am testifying today on behalf of NAFCU, the only national organization exclusively representing the interests of the nation's federally chartered credit unions. The organization is comprised of member-owned financial institutions representing approximately 30 million individual credit union members. NAFCU–member credit unions collectively account for the approximately 55% of the assets of all federally insured credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding credit card interchange fees.

The Electronic Payment System

The electronic payments system has proven to be one of the most important advances in the financial services marketplace in the last century. The system is tremendously beneficial to consumers, as well as merchants.

Consumers can travel the globe without worrying about having access to cash or exchange currency. Everything from a trip to the supermarket or gas station is made simpler and more convenient thanks to credit and debit cards.

The system has been equally beneficial for merchants. Retailers reap tremendous benefits in the form of increased sales, reduced costs for overhead (such as accounting for and transporting cash), substantially fewer fraud losses, and ***immediate*** payment for goods and services. There is a transfer of risk from the merchant to the financial institution. The financial institution assumes the risk of non-payment and fraudulent charges while the merchant receives their payment. Indeed, credit and debit card sales helped Wal-Mart ring up more than $375 billion in sales last year. It is also instructive to note that Exxon-Mobil, Royal Dutch Shell, Chevron, and BP were the first, third, fourth, and fifth most profitable companies in 2008, according to Forbes Magazine. Based on the profits of the largest gasoline manufacturers, perhaps gas station operators should look to cut costs by negotiating a cheaper wholesale price for gasoline rather than advocating for price controls on interchange fees. Further, the explosion in internet commerce would have been virtually impossible absent the electronic payment system.

The proof of the system's success lies in its popularity among consumers and merchants. Last year, there were more than 40 billion electronic payment transactions. Plastic is quickly growing more and more popular with consumers. Likewise, more and more merchants are also signing on to use the Visa and MasterCard networks. The system is working exceedingly well. Introducing price controls into the electronic payments system is unnecessary and potentially very harmful.

H.R. 2695, The Credit Card Fair Fee Act

H.R. 2695, the *Credit Card Fair Fee Act of 2009*, would give merchants an exemption from federal antitrust laws, allowing them to negotiate in an anti-competitive manner in order to shift their payment card acceptance costs to consumers, credit unions, community banks and other financial institutions. The focus of H.R. 2695 is to have the big players who reap the benefits from economies of scale do the negotiating, potentially leaving smaller entities behind. While we appreciate the recognition of credit unions and their ability to opt-out of the negotiated settlement in the bill, we find this language potentially troublesome, as it could create a system where plastic cards from credit unions are viewed differently by merchants and consumers than those from other institutions. It is with these concerns in mind that we oppose the bill in its current form.

The Importance of Interchange to the Credit Union Industry

The electronic payment system and the interchange fee structure that supports the system are incredibly important to the credit union industry. The electronic payment system is integral in allowing credit unions to compete with the largest financial institutions. Credit and debit products are important tools in developing, fostering and maintaining relationships with our members. Interchange fee revenue also helps cover the cost of maintaining the payment system; a cost which, contrary to merchants' arguments, is not negligible.

The current structure allows credit unions to compete with even the largest national banks. Credit union members who use a debit or credit card issued by their credit union know their card is substantially the same as what they would receive at Citibank, Wells Fargo, or any of the other industry giants. Given the ubiquity of plastic cards, it is critical that credit unions and other small financial institutions continue to be able to compete in this important market.

Capping or placing new restrictions on interchange fees, however, would ultimately provide an advantage to large financial institutions at the expense of credit unions and other small financial services providers. As of December 31, 2009, the average size of a federal credit union, for example, was $102.4 million, compared with $1.636 billion for banks. About 3,000 credit unions have less than $10 million in assets. The credit union share of total household financial assets is also relatively small, at just 2 percent as of December 2009. Given Chartway's per transaction cost, coupled with our customer base – which is smaller than that of a typical commercial bank – we will find it more difficult than larger institutions to offset the losses from a cap on interchange fees. By comparison, large banks with economies of scale and large credit and debit card portfolios would be able to internalize the loss much more easily, as a simple consequence of the fact that they have more customers. Further, credit unions also have a number of restrictions on the businesses they can engage in, as well as stricter capital requirements. Consequently, credit unions have fewer avenues to offset any losses created by a cap on interchange fee income.

If merchants receive an antitrust exemption, they will be permitted to "negotiate" their costs in an anti-competitive and collusive manner, and they will likely be able to force agreements to pay an artificially low price for payment card acceptance. Merchants receive tremendous benefits from payment card acceptance, including a shift of credit risk to others, increased sales, the ability to transact with anyone anywhere in the world (including via Internet), and increased customer satisfaction. They should pay their fair share for these and other benefits. If merchants do not pay their fair share for payment card acceptance, those costs must be borne by someone else, such as consumers and credit unions. This will result in higher costs for payment cards, less availability of payment cards, and reduced benefits associated with payment cards.

Conversely, if credit unions and other small issuers opt-out of the negotiated rates, they may find an environment where their plastic cards may be overtly or covertly discouraged by merchants. This could create an environment where the plastic card in your wallet from Chartway FCU is no longer viewed the same as a plastic cards from Citibank or other large issuers. Credit unions and their 92 million members stand to be losers under this scenario.

Certainly many credit unions will be able to continue operating their portfolio even with a new limited fee. Just as certainly, however, some credit unions will either exit the plastic card market and/or merge with larger credit unions. Given the consolidation from 20,000 credit unions to the approximately 7,700 that exist today, any measure that will lead to further consolidation should be carefully considered.

Further, it is important for Chartway FCU, as a brand – as well as all other credit unions – to have our members carrying our cards in their wallets. In today's financial services marketplace, it is not uncommon for a consumer to have their primary checking account at one institution, a credit card from another institution, a mortgage from a third, and money market or retirement account somewhere else. Indeed, there is no limit to the combinations available today for consumers who wish to shop around for their financial service products. Credit unions are member-owned organizations that offer the financial products that their members want. Surveys have shown that credit union members value the service that they receive from their credit union. By offering fundamental products like plastic cards, we help build relationships with our members so that we can continue to serve them when they are looking for other financial services.

If interchange fee income is essentially capped, it will be doubly painful for credit unions. First, it will be more difficult to provide our members a credit or debit card. Credit unions are not-for-profit cooperatives, meaning that they cannot raise capital from the markets and have no stockholders. Instead, all of their capital comes from their members and it is returned to the institution and the members (in the form of lower rates, higher dividends, more services, etc.). Federal credit unions are the only financial institutions with a statutory usury ceiling limiting the rates that they charge members. Simply put, credit union members often receive better services and rates on their credit cards from their credit unions as compared to other types of institutions. Second, if credit unions had to drop or cut back their plastic card programs because of changes in the interchange system, credit union members would likely seek these products from other institutions that may be less consumer-focused.

The Australian example can be helpful in understanding the impact interchange fee limitations will have on merchants, financial institutions, and consumers. In 2003, Australia became one of the first countries in the world to impose artificial restraints on interchange fees and other card network transactions. Although merchants benefited from savings because of their lower service charges, the Reserve Bank of Australia itself found that there was no conclusive evidence these savings were passed on to consumers in the form of lower prices. Furthermore, to make up for the losses, card issuers in Australia were forced to reduce rewards and raise annual fees following the interchange fee cap, which in the end only resulted in a higher cost to consumers.

Chartway FCU and the Interchange System

For many financial institutions, interchange fee income is not the huge income generating engine that the merchants make it out to be. In 2009, Chartway processed over 15 million transactions worth in excess of $500 million dollars for more than 43,000 credit card users and 85,000 debit card holders. On average, Chartway made 15.8 cents on each transaction it processed last year. This interchange fee income is vital in allowing Chartway to offer credit and debit card services to our members.

In order to understand the importance of interchange fees, it is critical to also understand the costs associated with maintaining the system. Simply put, the 15.8 cents per transaction that Chartway made in 2009 is not pure profit. Merchants argue interchange fees should be going down to reflect the smaller per transaction cost of clearing a payment. However, simply clearing a payment through the system is only one of a number of costs associated with issuing credit and debit cards and processing payments. First, the system does not simply run itself. Chartway FCU employs 11 people internally for debit card support, and a large service provider externally for credit card support to ensure our debit and credit card portfolio is operating smoothly and that our members are satisfied with their service.

Another significant cost associated with the system is with fraud losses. In a recent report from Aite Group, U.S. card industry fraud losses for 2008 were estimated at $8.6 billion. In nearly all situations, it is the financial institution that covers those losses. Federal law caps the amount that can be charged to a consumer if his or her account is fraudulently accessed. Further, Chartway, like most other financial institutions, will reimburse members in full for any fraudulent transactions made on their account. On average, Chartway spends over $450,000 a year to cover fraud losses and insurance for fraud. This number would also be considerably higher if Chartway had not made an aggressive effort to seek reimbursement for fraud losses.

Importantly, the figures above only capture actual fraud losses. There are a number of other costs associated with each instance of fraud, which are not captured by the statistics, nor are they covered by our insurance policy. Employee time must be spent contacting and working with members to resolve problems. Accounts may need to be shut down entirely and new account numbers issued. New plastic cards may need to be printed. In extreme cases, such as with the TJ Maxx data breach, financial institutions may find themselves issuing thousands of new cards and setting up call centers to respond to customer concerns. On top of this, the GAO has found that financial institutions also assume the risk that a merchant will not deliver the goods or services promised at the time of purchase, as when a merchant becomes bankrupt. Interchange fees help offset all of these substantial – and growing – costs.

My colleagues and I in the financial services industry find it particularly troublesome that merchants are seeking to reduce interchange fee income even as we suffer more and more fraud losses at the hands of thieves who access information through poorly protected merchant databases. If the Committee wants to help protect our nation's consumers with this legislation, you should add provisions holding those who fail to protect sensitive data responsible for the full costs of any losses that they may occur as a result.

In addition, it is important to note that debit cards and some credit card accounts generate little income outside of interchange. Debit cards, for example, have no cost for Chartway's members. Credit cards obviously generate income in the form of interest. However, that interest rate is calculated to reflect the risk of nonpayment or late payment, and does not include the cost of maintaining the account. Further, 34% of our active credit card accounts at Chartway are paid in full at the end of every month. Consequently, for these members, Chartway does not receive any interest income. In fact, quite the opposite; Chartway is essentially providing these customers a short term unsecured loan at no interest. Interchange fees help cover the costs of these products.

This proposal, however well intentioned, would be potentially disastrous for the credit union industry, particularly for smaller credit unions. Credit unions are not-for-profit institutions. Our industry operates on thinner margins, with less income, a smaller customer base and fewer total assets than traditional banks. As not-for-profit institutions, the income that is generated from interchange is reinvested in higher yields for our members, lower interest rates on loans and superior customer service. If fees are set at an artificially low price, it will be smaller institutions that suffer while large banks will be able to internalize the loss in income, and will likely end up with new customers that small institutions no longer can serve. This is not to say the credit union industry will cease to exist if interchange fees are capped; however, new interchange limits will, undoubtedly, have an effect on the industry. Just as certainly, those effects will be felt most directly by the smallest members of our industry.

Common Misconceptions about the Interchange System

There are several fundamental misconceptions about the interchange fee system that need to be addressed. It is impossible to grasp the consequences of H.R. 2695 without a firm understanding of the system's structure. Merchants have benefited from the system's complexity by making arguments that those well versed with the intricacies of the system know to be untrue. With that in mind, I would like to address a few of the most common arguments regarding the current interchange fee structure.

First, the interchange fee is not a hidden tax or fee on consumers. Just like the cost of labor, electricity, gas, rent or insurance, interchange fees are a cost of doing business. Further, interchange is a cost that retailers can and do pass on to their customers in the final price of the goods and services they sell. Furthermore, any increased revenue merchants earn as a result of paying lower fees for card services is unlikely to result in lower prices for consumers. The Government Accountability Office (GAO) found in their report last November (GAO-10-45) that it is "unclear" if merchants would pass any additional savings on to consumers from new lower interchange rates. Unfortunately, merchants continue to mislead the public by trying to present interchange fees as a consumer issue. If the Committee is intent on moving this legislation forward, it should include provisions requiring merchants to pass any savings on to consumers.

Next, retailers do not pay the interchange fee. Retailers pay a separate fee known as the merchant discount fee. This distinction is vital in understanding the debate regarding interchange fees. The interchange fee is the fee that a merchant's bank pays an issuing institution, such as Chartway FCU, to process a transaction. The merchant, in turn, pays its bank the merchant discount fee on each transaction. The interchange fee is one component in the merchant discount fee that the merchant pays. This distinction is significant for two reasons.

First, *the merchant discount fee the fee the merchant actually pays is already negotiable*. Merchants can and do negotiate with their bank for a lower merchant discount fee. Further, merchants are free to choose a new bank altogether if they can find a better rate elsewhere.

Second, this simple fact that merchants do not pay the interchange fee is integral in understanding why merchants have limited ability to negotiate the fee. In this sense, the interchange fee is one of several costs associated with the final, retail product (the merchant discount fee). This system is no different from any other retail product. For example, consumers do not get to negotiate the price their local diner paid for the eggs in their omelet, even though being able to do so might result in a cheaper breakfast.

The current interchange fee structure is transparent for retailers. Merchants have argued that they do not know what the fees are for each card. A simple search on Google.com for "Visa interchange rates" or "MasterCard interchange rates" will yield information from Visa and MasterCard respectively on what the rate is for each kind of transaction. That said, the rates are complex and they vary depending on the type of card and the type of retailer, whether it is a pin or signature transaction and several other factors. However, to claim that merchants have no information regarding the cost of interchange is simply not true. It should be noted that many of the corporations advocating for the passage of H.R. 2695 are large, sophisticated entities with the tools and expertise necessary to understand the system.

The fact that retailers do not know the exact cost of interchange at the point of sale is a necessary consequence of the complexity of the system and the different options available. Further, it is important to keep in mind that merchants do not pay the interchange rate; they pay the merchant discount fee. In some cases, the merchant discount fee is a set percentage of the transaction. Consequently, even if a retailer does not know the price of interchange on a transaction, they do know the price they are actually paying to process the transaction.

Responding to the merchants' arguments has grown more and more daunting as their expressed concerns with the system change from day to day. The ever changing criticism of the system is indicative of the fact that there is nothing wrong with the system. Merchants want little more than a price control for this cost of business. Consequently, they have draped this ultimate desire in whatever argument they find expedient or compelling at that particular point in time.

Conclusion

NAFCU strongly opposes H.R. 2695 in its current form. If mandatory negotiations force new caps on interchange fees, they will enrich merchants while harming credit unions and consumers. Additionally, if credit unions opt out of this new process, they may find themselves for the first time in a situation where their plastic cards are viewed disparagingly when their 92 million members try to use them at merchants.

The electronic payments system has proven incredibly beneficial to merchants. Retailers, however, want all of the benefits of the system, while at the same time they are asking Congress to simply cut their costs of doing business. As a businessman, I certainly understand why retailers would like to cap their costs for processing transactions. As a consumer, however, I am weary of the government interfering with a valued product that has been incredibly successful and which I use on a daily basis. Finally, lower interchange fees are not going to be translated into cheaper prices for consumers. The one thing that is clear is that the passage of H.R. 2695 in its current form will hurt credit unions and their 92 million members.

Mr. CONYERS. Our final witness is Douglas Kantor, a partner at Steptoe & Johnson, and he represents the National Association of Convenience Stores, the Society of Independent Gasoline Marketers, and the Merchants Payments Coalition. He has also worked at the Department of Housing and Urban Development as chief of staff.

And we welcome you to the Committee.

TESTIMONY OF DOUGLAS KANTOR, GOVERNMENT AFFAIRS AND PUBLIC POLICY, STEPTOE & JOHNSON, LLP, ON BEHALF OF THE NATIONAL ASSOCIATION OF CONVENIENCE STORES, THE SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA, AND THE MERCHANTS

Mr. KANTOR. Thank you, Chairman Conyers.

Thank you, Ranking Member Smith and Members of the Committee, for having me here today and giving me the opportunity to testify on the subject of interchange fees in the Credit Card Fair Fee Act. I am counsel to the Convenience Stores Association, the Gasoline Marketers, and the Merchants Payments Coalition, which includes more than 20 national trade associations and 80 state trade associations, all of whom are very concerned about the interchange fees that they pay each and every day on credit and debit cards.

There are a couple of problems I would like to describe for you which cause these issues for merchants around the country. The first is that what happens with this system is that Visa and MasterCard centrally set the interchange fees that the banks that issue the cards charge—not the fees that Visa and MasterCard themselves charge, it is what the banks charge. And what we find is, all of those banks that are supposed to be competitors—Bank of America, Citibank, JPMorgan Chase, you name it, the largest of the large—do charge the same schedule of fees to merchants.

This is price fixing; it is centralized price fixing. Those banks compete on all the other aspects of their business, but not on this one. And the result is quite predictable. The result is, these fees have grown out of control and are at anticompetitive levels.

But that is not the only problem here. The other part of the problem here is that Visa and MasterCard also set a series of terms and rules that constrain the marketplace and ensure that there is no price competition here, and that consumers who make the ultimate choice of what card to use can't make market-based decisions on those choices.

So, for example, the most egregious one of these rules that both Visa and MasterCard have is that they prohibit merchants from offering their consumers a discount if those consumers will agree to pay with a card that has cheaper fees. It would be easy if merchants could say, "Hey, Discover Card is a little cheaper for me; I will give you a dollar off if you will use your Discover Card," or, "I will give you 1 percent off."

But that is prohibited by Visa and MasterCard. On the threat of fines to that merchant there cannot be that type of competition.

Imagine for a moment, if you will, if Coke and Pepsi each had a rule that said, "You can never sell my competitor's soft drink for anything less than you sell mine or I will fine you for it or take away your ability to sell Coke or Pepsi." This Committee and the Department of Justice would be quite upset at that, and, not surprisingly, the cost of those soft drinks would go up precipitously, but that is just what we face on the interchange fee.

The problems that this causes across the marketplace—and this combination of things causes—is profound. The fees were $48 billion in 2008. They have gone up faster than any other business expense for these merchants.

For most merchants across the Nation, including what Dave Carpenter reported from his own business' results, this is the second-highest operating expense they have after only labor, and in some cases it is pushing labor and giving it a run for its money. These fees have gone up faster than any other expense including health care costs.

Just to give you an example, Robert Shapiro, the former undersecretary of commerce for economic development, put out a study earlier this year, and he found that just based upon the amount he estimated merchants were passing through to consumers of these fees and just based upon the amount above the cost of processing and a rate of return, if you took that out of the system consumers would have nearly $27 billion more to spend across the economy, and that that stimulus would result in the creation of 242,000 jobs across the country.

When prices are higher people buy less and there is less economic activity. That flows through the whole economy of suppliers all the way down to the merchants and everyone gets affected.

Consumers, as Mr. Mierzwinski pointed out, are deeply affected by this, too. They pay higher prices at the store and at the pump, and there is a regressive cross-subsidy, where lower-income people pay more to pay for some of the rewards and other frills that higher-income people get.

That is not right from where we sit; it is not right for consumers. And consumers don't get the basic disclosures that tell them what is here.

So we are very much in favor of the Conyers-Shuster legislation that is before the Committee, and that it would give us a chance to negotiate both the fees and the rules that constrain the system and begin to bring some market pressures to this system where no market pressures currently are allowed to go.

I thank you for your consideration.

[The prepared statement of Mr. Kantor follows:]

PREPARED STATEMENT OF DOUGLAS KANTOR

TESTMONY OF DOUG KANTOR

PARTNER

STEPTOE & JOHNSON LLP

ON BEHALF OF

THE NATIONAL ASSOCIATION OF CONVENIENCE STORES (NACS)

THE SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA (SIGMA)

AND

THE MERCHANTS PAYMENTS COALITION (MPC)

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON THE JUDICIARY

HEARING ON

H.R. 2695, THE CREDIT CARD FAIR FEE ACT

APRIL 28, 2010

Chairman Conyers, Ranking Member Smith and Members of the Committee, I am honored to appear before you today and appreciate the opportunity to share my views on the Credit Card Fair Fee Act. My name is Doug Kantor. I am a partner in the law firm of Steptoe & Johnson LLP and am counsel to the National Association of Convenience Stores ("NACS"), the Society of Independent Gasoline Marketers of America ("SIGMA"), and the Merchants Payments Coalition ("MPC").

NACS is an international trade association representing the convenience store industry. The industry as a whole includes about 145,000 stores in the United States, sells nearly 80 percent of the gasoline in the nation, and employs about 1.7 million workers. It is truly an industry for small businesses; more than 60 percent of convenience stores are owned by one-store operators.

NACS and SIGMA are both members of the MPC. The MPC is a group of more than 20 national and 70 state trade associations representing retailers, restaurants, supermarkets, drug stores, convenience stores, gasoline stations, theater owners, on-line merchants and other businesses that accept debit and credit cards. MPC 's sole mission is securing a more competitive and transparent card system that works better for consumers and merchants alike. The coalition's member associations collectively represent about 2.7 million locations and 50 million employees. These merchant associations account for more than 60 percent of the non-automotive card based transaction volume in the United States.

The bipartisan legislation being considered by the Committee today, H.R. 2695, the Credit Card Fair Fee Act, would help address an important competition policy problem – the setting and imposition of swipe fees by the major credit card companies and their bank members. The MPC endorses H.R. 2695 and deeply appreciates the efforts of the bill's primary sponsors, Chairman Conyers and Representative Shuster, along with all of the cosponsors of the bill.

Swipe fees are a critically important issue to businesses and consumers across the nation, and the economy as a whole. The centralized setting of the swipe fees charged by banks that issue credit and debit cards as well as the conditions for acceptance of those cards amounts to nothing less than price fixing and an illegal restraint of trade. Many of the rules imposed by the major credit card companies also constrain the marketplace to prevent competition in violation of the antitrust laws. This is an issue with which Congress must grapple. While ongoing litigation will eventually show that Visa, MasterCard and their banks have violated the antitrust laws, those lawsuits could take years to be resolved and for remedies to be implemented. Congress must provide the solutions now to the key problems currently in the system and Congress is the right place to answer the questions about how the system should operate fairly in the future. The Conyers-Shuster bill goes a long way toward providing those solutions.

My testimony today will address several major points. First, I will describe the current competition policy problems with the swipe fee system in the United States. Second, I will detail the impact caused by these problems. Third, I will discuss how the Conyers-Shuster bill helps to solve those problems. Finally, I will address some of the myths that have at times been raised in the context of this issue in order to set the record straight.

I. The Problem with Swipe Fees

There is broad international consensus that swipe fees pose unacceptable anti-competitive, anti-consumer antitrust problems. Indeed, after many years of study and debate, regulators from Australia, the European Commission, Spain, New Zealand, Hungary and others have reached this conclusion and taken action. The most egregious problems these countries and many in America have found are described below.

A. Centrally Setting the Fees

Swipe fees collectively deprive businesses that accept credit and debit cards as well as consumers of the benefits of competitive market forces because they are centrally set by Visa and by MasterCard. These two companies have been found by the U.S. Court of Appeals for the Second Circuit to have market power under the antitrust laws both individually and collectively.[1] Each of the two credit card giants decides upon a schedule of default fees for the banks that issue their cards to charge for transactions. Note that these fees are not charged by Visa and MasterCard themselves. Instead, they are fees that banks that are supposed to be competing with one another charge – and some of those banks sit on the boards of Visa and MasterCard to help decide the fees they and their competitors will charge.

That is a profound problem. Banks including Bank of America, JP Morgan Chase, Citi, Wells Fargo/Wachovia and others compete with one another in the other aspects of their businesses. Yet when it comes to swipe fees, they collectively agree to charge the same schedule of fees. The result is just what you would expect to happen if another industry did the same thing. If, for example, grocers all agreed to charge the same prices for milk as their competitors, we would all expect the price of milk to be much higher than a competitive market would produce. Our antitrust policy prohibits this type of central price-fixing because it takes away the primary benefit of our economic system – the incentive for competitors to try to gain market share through price competition.

This activity cannot be excused because Visa and MasterCard have changed their corporate form. Until a few years ago, both Visa and MasterCard were simply associations of their member banks. Even they realized, however, that setting prices for their association members created potentially serious legal liabilities. So, they both became corporations offering their shares to the public. This change, however, was nothing more than an attempt to put form over substance. Each company still serves as the price-setting body for its member banks (including member banks that sit on the boards of the companies and participate in the price-setting). The change in corporate form does not change the reality – the banks agree to let the major credit card giants fix their prices for them.

The fact that the card companies say their rate schedules are "default" rates and that banks are free to depart from them is little more than rhetorical posturing. There is no incentive for banks to depart from the schedule of inflated fees that their competitors follow and we are not

[1] *United States v. Visa USA, Inc.*, 344 F.3d 229 (2d Cir. 2003).

aware of such departures. In fact, retailers have been told many, many times by their bankers that the bankers cannot depart from the agreed upon rate schedule. As with other price-fixing examples, the banks know that they are better off sticking to the collective pricing rather than departing from it.

B. Rules that Hide the Fees

The major card companies not only centrally set prices, but they establish the rules for the credit and debit card systems. These rules include a series of complementary provisions that serve to hide fees in the cost of goods and services that consumers pay and insulate the fees from competitive pressures.

Perhaps the most egregious of these rules prohibits merchants from giving a pricing advantage to one card company's products over another one's. This could be done, for example, through giving consumers a discount to use Visa rather than MasterCard or the other way around. Both Visa and MasterCard prohibit merchants from doing this.[2] If a merchant runs afoul of this rule, the risk is the imposition of large fines (often $5,000 per day) or cutting off the merchant's ability to accept these cards.

The impact of these rules is that no card company has any incentive to reduce its fees. The reason companies reduce prices is to get more customers, but Visa and MasterCard make sure that the consumers who decide what card to use cannot get a benefit from reduced fees and that any fee reduction then will have no impact on transactions or market share. This is just like if Coca-Cola and Pepsi, to take one example, were to tell stores that they could never have a sale and price their competitor's products lower than their own. With that rule in place, how many discounts do you think we would see for Coke or Pepsi? The answer is none and prices would steadily rise as a result. That is just what we face here and it is one key leg of the table artificially propping up swipe fee prices.

The card companies have related rules that make it very difficult for merchants to give their customers other types of discounts. Discounts for cash, checks and debit cards, for example, might bring some market pressures to bear on the size of interchange fees. But Visa and MasterCard both have byzantine sets of rules regarding the way merchants can display any such discounts. The rules have at times contradicted state consumer protection laws and forced merchants to decide to either violate the Visa/MasterCard rules or violate state law. The result, as the card companies know well, is that merchants typically choose a third option – don't give any discounts because it is not worth the risk.

Typically, merchants quickly back down from the Visa/MasterCard threats about discounting, but a controversy over their heavy-handed tactics made its way into the press in California a few years ago. Visa threatened a couple of gas station owners – including a single store operator – if they continued to offer cash discounts. And, in that instance, Visa instructed the station owners that they should display their prices and discounts in a way that would violate California law. When asked about this by the publication *Oil Express*, Visa spokeswoman

[2] *See* Visa U.S.A. Operating Regulations 5.2.D.2; MasterCard Rules 5.9.1.

Rhonda Bentz reacted in a way that is incredibly revealing of Visa's hubris and the way it treats merchants. She said, "It's great if they have a contract with the state, but they don't. They have a contract with Visa and if they don't want to abide by that contract, they shouldn't have signed it." The *Oil Express* article from April 23, 2007 is included with this testimony as Exhibit 1.

California Weights and Measures Director Dennis Johannes saw Visa's tactics for what they were. He said Visa was "heavy handed" and noted, "They probably don't want dual pricing because it discourages the use of their credit card." Of course, that is precisely the type of market pressure that our system depends on to keep prices down. If Visa doesn't want people to be discouraged from using their cards, they should lower their prices rather than threatening merchants who offer cash discounts.

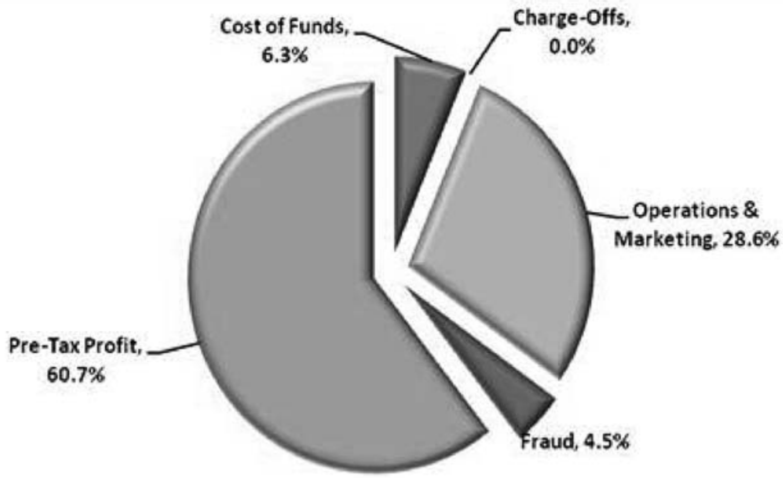
Yet another rule that helps erase any semblance of competition requires that merchants accept every single type of Visa or MasterCard no matter how high the fees are for that card – or accept no cards at all. The upshot of this rule is that when new cards come into the market, the card companies do not need to seriously consider whether the prices they set will cause people not to take the card. To take the soft drink example again, when companies come out with a new flavor of Coke or Pepsi, those companies need to think about the price point and whether merchants will carry the new product and consumers will buy it. If the price is too high, then the product won't be successful. If they had a rule saying that every store had to buy all of their products no matter the price or be prohibited from carrying any of their products, that would raise the problem of product tying under the antitrust laws. But Visa and MasterCard both have this type of rule. The origin of this rule was well-intentioned – that merchants treat different bank issuers of cards in the same way and not refuse a consumer's card because the bank was unfamiliar to the merchant. This rule, however, has gone beyond all reasonable bounds and no longer just ensures that bank issuers are treated fairly. It now prohibits merchants from taking any action to protect themselves against rapidly escalating fees on newly issued card products.

II. The Impact of Swipe Fees

A. The Impact on Business

Dave Carpenter, the owner and President of Shortstop stores who is also testifying today, can describe the impact of these fees on his business much more eloquently than I can, but I can try to bring some additional perspective to this. For many retail industries, swipe fees are their second highest operating expense after labor. That means swipe fees cost these businesses more than rent on their stores, utilities, and other overhead. Retail profit margins are very, very narrow. The retail sector of the economy is highly competitive and if costs go down for those businesses, then their prices go down. Retail profit margins are consistently narrow in the United States. Exhibit 2 to this testimony includes charts from Fortune magazine comparing the profitability of different U.S. industries for each year from 2006 through 2009. There isn't a single category for retail, but they have numbers for "Specialty retail", "Food and Drug Stores" and "Automotive retailing" -- these cover large parts of the retail industry. The numbers show that each of these industries consistently rank near the bottom of all industries in terms of profitability and have very stable profit margins each year (many other industries are lower in particular years but fluctuate more). Specialty retail, for example, is between 3.2 and 4.0 percent profitability every year since '06. Specialty retail is about the most profitable sector of the retail industry. Food and drug stores are between 1.5 and 2.6 percent profitability each year. Automotive is less than that. This means that regardless of conditions in the economy the competition across retail businesses is such that revenues can never exceed costs by much – whether costs are rising or falling. Exhibit 3 to this testimony is National Retail Federation data. This tracks just large retail companies and finds profit margins between 2 and 4 percent – bearing out Fortune's numbers.

The difference between the narrow profit margins of the retail industry and the huge profit margins for banks on interchange is dramatic. The chart below shows that the profit margins on interchange are more than 60% based on data from *Cards & Payments*.



Card Issuer INTERCHANGE Profitability
Avg '06 to '08

These fees continue to escalate and business owners do not have a way to control them. They can take action to deal with utility costs, they can negotiate their rent and labor costs, but they can't deal with these cost increases. The inability to go to a competitor to get a better deal is simply devastating. In fact, economists with the Kansas City Federal Reserve have found that merchants cannot realistically refuse to accept Visa and MasterCard even though interchange costs far exceed any benefits those merchants receive by accepting cards.[3] While the card companies sometimes argue that merchants could stop accepting cards, the cards are so dominant now that that is not realistic. Visa, in fact, is promoting itself as "currency" in its marketing. Telling merchants they don't have to take cards, then, is like telling them they can refuse to take cash. While theoretically possible in some niche businesses, it is generally not realistic.

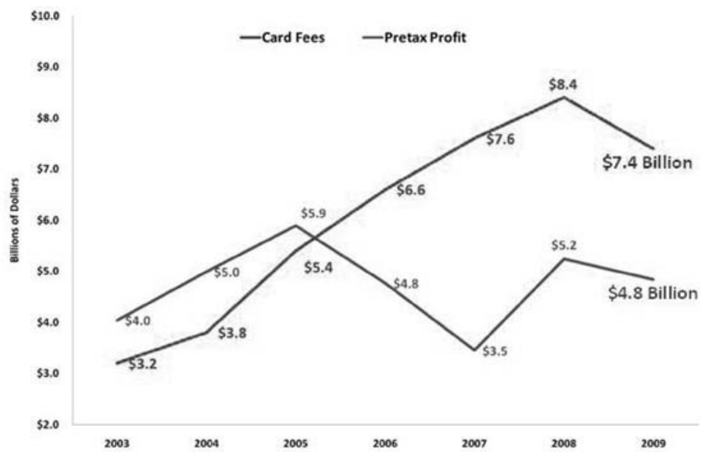
The dramatic jump in card rates – both in dollar terms and in terms of the rates charged – takes its toll on merchants. According to the Government Accountability Office (GAO) this is not just due to more people using cards but is the result of Visa and MasterCard increasing their fees. GAO wrote, "Visa and MasterCard officials told us that their average effective interchange rates applied to transactions have remained fairly constant in recent years when transactions on debit cards, which have lower interchange fee rates, are included. **However, our own analysis of Visa and MasterCard interchange rate schedules shows that the interchange rates for credit cards have been increasing and their structures have become more complex,** as hundreds of different interchange fee rate categories for accepting credit cards now exist."[4] Let's be clear about this, GAO concluded that what Visa and MasterCard told them about their rates remaining flat was false.

The increases in the rates set by Visa and MasterCard, along with increased card usage, has led to a huge increase in fees paid by merchants. The chart below shows how those fees have grown over time for the convenience store industry and shows industry profits per year as well. It is not a coincidence that as the amount of card fees jumped past the amount of profits the industry made, profits fell. Some of those profits have recovered and the fees dipped some for the first time in years due to the recession last year, but the fact that fees have been more than profits for 4 years in a row demonstrates the difficulties these fees cause for business. With the recession there was also a shift to more debit usage. The card companies must have seen that shift too because on April 16 they put into effect a 30 percent increase in debit fees.

[3] "A Puzzle of Card Payment Pricing: Why are Merchants Still Accepting Card Payments?," Fumiko Hayashi, December 2004.

[4] "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges," GAO-10-45, Nov. 19, 2009 ("GAO Report") at 14 (emphasis added).

Card Fees and Pre-Tax Profits in the Convenience Store Industry

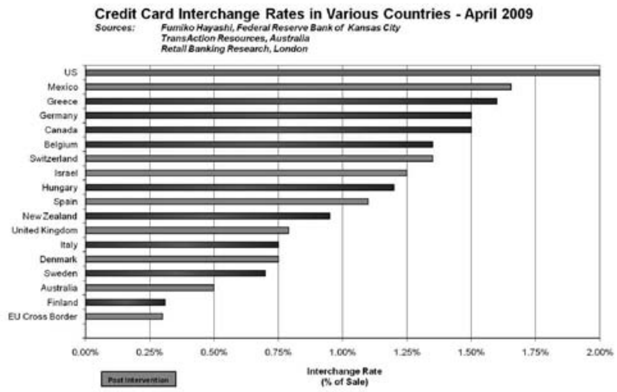


Source: NACS State of the Industry Survey of 2009 data powered by CSX

And these fees hit small businesses the hardest. While the card companies like to talk about the large retailers that might be helped by policy solutions to deal with swipe fees, the current system that they defend gives large retailers a decided competitive advantage over small businesses. The GAO found, "Merchants with large volumes of card transactions generally have lower interchange fee rates. Visa categorizes some merchants into three tiers based on transactions and sales volume, with top-tier merchants receiving the lowest rate."[5] That simply should not be. Unlike situations in which product needs to be manufactured and delivered to stores, there are no cost savings that justify better deals for large merchants.

These out of control fees disadvantage the U.S. economy. Interchange fees in this country are among the highest in the industrialized world as shown by the chart below.

[5] GAO Report at 10.



It is interesting to note that while some countries with lower interchange rates have taken action to deal with these fees, several countries that have done nothing pay lower rates than Americans do. The reason for that is straightforward. The two major card companies have such dominant market power here that they can engage in the anticompetitive practices that I have described without fear of too many merchants leaving the network.

B. The Impact on Consumers

The impact of anticompetitive swipe fees on consumers is dramatic. American consumers pay inflated prices for virtually everything they buy because of these fees. And they pay these funds without even knowing it. Consumers never get a disclosure from their card issuer telling them any swipe fees are charged – not to mention how much they are. This is the card companies' model. By hiding their fees they can keep charging more and consumers won't notice. Last year, the Hispanic Institute studied this phenomenon. They found that the business model by which fees are embedded in retail prices without disclosure combined with the rewards that some cardholders get leads to a regressive transfer of wealth from low income consumers to high income consumers. This regressive wealth transfer is more than $1 billion every year.[6] And this did not even take into account the 27 percent of U.S. families who do not even have credit cards – but are still paying inflated prices due to interchange.[7]

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[6] "Trickle Up Wealth Transfer: Cross-subsidization in the payment card market," The Hispanic Institute, November 2009 at 5.

[7] Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, February 2009, at 46.

Retailers are not the only ones who have come to the conclusion that swipe fees hurt consumers. John Blum, who is here as a witness again today, testified on behalf of the National Association of Federal Credit Unions (NAFCU) before the Antitrust Task Force of this Committee on May 15, 2008. In his written testimony he said, "Further, interchange is a cost that retailers can and do pass onto their customers in the final price of the goods and services they sell."[8] It appears then that NAFCU agrees with the Hispanic Institute – consumers are paying interchange fees right now, but the fees are hidden in the price of goods and services those consumers buy.

The card companies have strenuously argued that if anything at all happens to reduce swipe fees, then other fees paid by consumers will increase and consumers will be in a worse position than they are today. This is false. In fact, the European Commission's Directorates for Competition and Financial Services jointly conduct a comprehensive study into the European payment card industry in general, and Visa and MasterCard in particular. The Commission found no evidence to support the card systems' arguments in favor of benefits to consumers of the high fee levels associated with the existing interchange fee mechanism. In particular, the Commission rejected arguments that lower interchange fees to merchants would result in higher fees to consumers:

> There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee would have to be compensated with higher cardholder fees The evidence gathered during the inquiry rather suggests that the pass-through of higher interchange fees to lower cardholder fees is small. Consumers already pay the cost of the interchange fee without knowing it. This cost is now hidden in the final retail price and is therefore non-transparent.

Similarly, the Australian experience has refuted claims that decreases in interchange fees would undercut the viability of card systems. In fact, after several years' experience with reduced interchange fees, the Australian central bank has concluded that card issuers have responded to lower merchant fees by offering consumers a choice: Low cost cards with low interest rates and fees and no rewards, and rewards cards with higher interest rates and annual fees.

Indeed, this resulting *price competition* is precisely the outcome the card systems feared: For example MasterCard had complained to the Australian Reserve Bank about having its members forced to compete on price:

> MasterCard does not disagree that there is, at present, strong competition amongst issuers of credit cards. Such competition has been enhanced by the fact that, at present, issuers have been able to recover eligible costs.... One distinct characteristic of the product

[8] Testimony of John Blum, Vice President of Operations of Chartway Federal Credit Union, before the House Judiciary Committee Antitrust Task Force, May 15, 2008 at 8.

> offerings in recent times, however, has been the increase in the number of "low cost" credit card offerings. While MasterCard believes that it is beneficial for there to be "low cost" credit card products being offered, it also believes that, with the common benchmark interchange fee, in the future there will be fewer "fully featured" credit card offerings and the competition between issuers will be based on increasingly homogeneous "low cost" credit card offerings.

That is precisely the result that would be best for consumers. Once the card companies in Australia stopped competing for market share by raising the fees their banks would earn (which the bank could in some small measure plow back into enticing rewards for consumers), they had to compete on interest rates in order to attract consumers directly. That is what Australian consumers really wanted and what they have been getting since their system was reformed. Interest rates on credit cards fell precipitously after the reforms and even though the overall rates in that country have fluctuated over time, the spread between their benchmark rates and the rates consumers get on their credit cards is consistently narrower than it was prior to Australia's reforms. U.S. PIRG and other consumers groups educate consumers that the most important thing to look at when evaluating cards is the interest rate. Once Australia took some of the confusing subterfuge out of the system by reducing the hidden fee-reward cycle, consumers there were able to focus on interest rates and get better rates.

III. The Solutions in the Conyers-Shuster Bill

The Conyers-Shuster bill would help solve these problems by allowing market-based negotiations to take place on a level playing field. Right now, thousands of banks band together to set their pricing. Merchants either individually or in small groups cannot effectively deal with that combined market power. The credit card industry insists that its collective price-setting is necessary. While there are good reasons to doubt that claim, Congressmen Conyers and Shuster have taken them at their word. Their bill would, however, allow merchants to act in a similar fashion and collectively bargain with each of the dominant card associations and their banks. The bill also asks the Department of Justice to report back to Congress on the negotiations.

The bill requires that any agreements that are negotiated be made public. It requires that certain information be exchanged to form the basis of the negotiations. And the bill includes important protections for small merchants and small bankers. It requires that agreements reached cannot disadvantage smaller merchants and bankers in the group. The bill even gives small bankers the opportunity to opt out of the negotiations if they choose.

The bill also includes language to ensure that the ability it gives each side to bargain as a group is narrowly limited to the swipe fees and attendant rules of the system. The bill also ensures that it could not be used for one side to engage in a group boycott. There is nothing in the bill that prejudges the outcome of the negotiations are requires that a deal occur. In the past, there was a dispute resolution mechanism in the bill in case the sides did not reach agreement, but that provision was removed during the last Congress as a compromise.

It is, in fact, interesting that the card companies and bankers oppose this bill so strenuously. Why shouldn't merchants have the right to act collectively in the way the banks do already? There is nothing in the bill that says they couldn't try to negotiate a better deal than they have now on interchange. Of course, they must realize that there is no way for them to justify the size of the fees they charge and the anticompetitive rules they impose. Otherwise, they would be quite comfortable with the type of negotiation that would be enabled by the Conyers-Shuster bill.

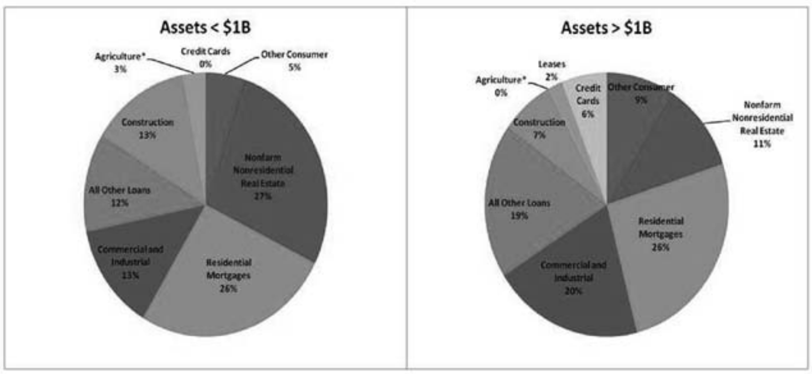
IV. ADDRESSING THE MYTHS

Unfortunately, there are several myths that have obscured the debate of the unfair way in which the interchange system operates. I suspect that several Members of the Committee have heard these myths. In light of this, I would like to address some of the major ones and provide you with the facts.

Myth: *Small banks and credit unions will suffer if the interchange fee system is reformed.*

Reality: The current interchange fee system overwhelmingly benefits a very small number of very large banks. Only 10 large banks collect more than 80 percent of interchange fees. Let me make that clear. That's not the top 10 percent of banks – I am just talking about 10 banks. No one after those 10 banks even has 1 percent of the market. I have included as Exhibit 4 with this testimony the lists of market share in the credit card, PIN debit card, and signature debit card markets so you can see who gets interchange fees and in what proportions. Given the rhetoric around this issue, these numbers are likely to surprise you.

In fact, as the charts below show, small banks make almost no money from credit card issuing. This is a big bank business. Institutions with less than $1 billion in assets (which is a pretty large institution), do not even make 1% of their revenues from credit cards as shown below.



* OTS – supervised savings associations do not identify agricultural loans

Source: FDIC, Quoted in American Banker, 3/20/09

I urge every Member of this Committee when they hear from small banks about this issue to make sure they get the answer to one simple question – what percentage of that small bank's total revenue comes from interchange fees. If they can't or won't answer that simple question, then it is hard to take their complaints about the Committee reforming this system seriously.

Small banks argue that they have higher costs for issuing cards and so they must be able to charge the same fees as their larger competitors. Of course, if that is true, then those larger competitors are making a huge windfall by fixing their prices with small banks. And clearly, as previously discussed, 60 percent profit margins certainly look like a windfall.

Small banks make only a tiny portion of total interchange fees and will not be hurt by allowing for collective negotiations – particularly given that the bill protects them so that they cannot do any worse than their large competitors in the context of any negotiated agreement.

Myth: *The credit card system works fine now. There is no need for legislation.*

Reality: The current system is broken. Visa and its member banks fix interchange fees in violation of the antitrust laws. MasterCard and its banks do the same. The result is that interchange fees are rising fast and cost the U.S. economy $48 billion in 2008 alone. That is triple what the fees were in 2001.

Not only are the fees skyrocketing so that merchants and consumers pay too much, but these fees change the nature of the credit card business in a way that hurts consumers. As Georgetown Law professor Adam Levitin observed in testimony before the House Judiciary Committee, the huge fee revenue the banks earn from credit card transactions taking place has created bad incentives. He testified, "The card industry's business model is the heart of the problem and needs to change. Just as with subprime mortgages, the credit card business model creates a perverse incentive to lend indiscriminately and let people get into so much debt they can't pay it back."[9] Others have clearly observed this trend as well. For example, Acting Comptroller of the Currency Julie Williams said in March 2005, "Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset . . . it's not repayment of the amount of the debt that is the focus, but rather the income the credit relationship generates through periodic payments on the loan, associated fees, and cross-selling opportunities."[10] These changes mean that banks are less worried than they should be about consumers' welfare. It should be in the interest of banks for consumers to do well and be able to pay back credit card loans. But the huge fee income the banks generate through interchange and other means gives them another incentive – milk consumers for all they are worth and don't worry about the money getting paid back.

The bottom line is that abuse of consumers by banks will continue as long as they have the incentive to treat people that way. Interchange fees are the key incentive with which Congress has not yet dealt. The abuses of consumers and using credit cards as predatory lending vehicles will continue until something is done about interchange fees.

Myth: *Congress shouldn't reform interchange fees because merchants will just pad their profits.*

Reality: Representative Peter Welch made an insightful observation on this point when he spoke with Politico and noted that this is an odd argument because the credit card industry is essentially saying "let us keep ripping people off or someone else will." The role of this Committee is to stop the card industry from engaging in rip-offs and then, if someone else is doing something wrong later, deal with that.

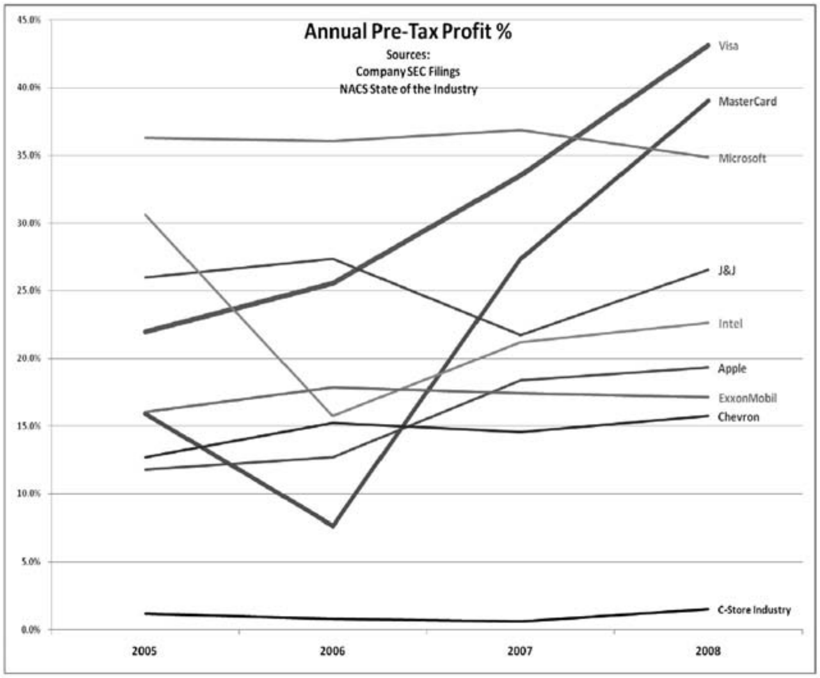
This argument also ignores the basic tenets of economics. Economics say that in the absence of a market failure higher business costs result in higher prices and lower business costs result in lower prices. The retail sector of the economy is

[9] Adam J. Levitin, Testimony before the House Judiciary Subcommittee on Commercial and Administrative Law, "Consumer Debt – Are Credit Cards Bankrupting Americans?" April 2, 2009.

[10] Remarks by Julie L. Williams, Acting Comptroller of the Currency, Before the BAI National Loan Review Conference, New Orleans, LA, March 21, 2005, at http://www.occ.treas.gov/ftp/release/2005-34a.pdf.

highly competitive and if costs go down for those businesses, then their prices will go down. First, let's look at how consistently narrow retail profit margins are in the United States. Exhibit 2 to this testimony includes charts from Fortune magazine comparing the profitability of different U.S. industries for each year from 2006 through 2009. There isn't a single category for retail, but they have numbers for "Specialty retail", "Food and Drug Stores" and "Automotive retailing" -- these cover large parts of the retail industry. The numbers show that each of these industries consistently rank near the bottom of all industries in terms of profitability and have very stable profit margins each year (many other industries are lower in particular years but fluctuate more). Specialty retail, for example, is between 3.2 and 4.0 percent profitability every year since '06. Specialty retail is about the most profitable sector of the retail industry. Food and drug stores are between 1.5 and 2.6 percent profitability each year. Automotive is less than that. This means that regardless of conditions in the economy the competition across retail businesses is such that revenues can never exceed costs by much – whether costs are rising or falling. Exhibit 3 to this testimony is National Retail Federation data. This tracks just large retail companies and finds profit margins between 2 and 4 percent – bearing out Fortune's numbers.

To put this in perspective, let's look at the profit margins for some large U.S. corporations. Note that Visa's profit margins are more than 40 percent and MasterCard's are close. Microsoft comes close to them but many other household names don't. Some major oil companies are between 15 and 20 percent. And way down at the bottom, one retail industry – convenience stores – have about 2 percent profit margins. Now, the credit card industry has accused these retailers of ripping off their customers. This chart makes clear who is ripping off who.



I would also note that the Department of Energy has studied how retailers that sell gasoline do or do not pass through costs into retail prices. They found that for both cost increases and cost decreases there is 100 percent pass through of costs into retail prices.[11] That means, without question, whether interchange fees increase or decrease, consumers will see those changes reflected in the cost of gasoline – for better or for worse.

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[11] U.S. Department of Energy, "Gasoline Price Pass-through," by Michael Burdette and John Zyren, January 2003.

The Hispanic Institute studied this question in its report issued last November. It found that "the data shows that lower interchange fees result in lower prices for consumers and higher interchange fees result in higher prices for consumers."[12]

Myth: *There is no need for reform because merchants can already negotiate fees.*

Reality: This claim is purposely misleading. Merchants cannot negotiate interchange fees. They negotiate with their local bank or processor on their processing fees, but those processing fees are much smaller than the interchange fees merchants pay. In most cases, processing fees are only about 10% of what the merchant pays. They are an add-on to what the merchant pays in interchange. Interchange fees are much larger – the $48 billion paid in 2008 was more than all of the credit card fees charged directly to consumers combined. The interchange gets passed through to merchants and, ultimately, to consumers. Merchants also have no ability to shop for better interchange deals. Visa's banks all charge the same schedule of interchange fees and MasterCard's banks do the same. The result is that there is no competitive market for interchange fees – just price fixing.

Myth: *There is no need for reform because credit card fee rates have remained flat.*

Reality: This is simply false. As noted previously, GAO found, "Visa and MasterCard officials told us that their average effective interchange rates applied to transactions have remained fairly constant in recent years when transactions on debit cards, which have lower interchange fee rates, are included. **However, our own analysis of Visa and MasterCard interchange rate schedules shows that the interchange rates for credit cards have been increasing and their structures have become more complex,** as hundreds of different interchange fee rate categories for accepting credit cards now exist."[13]

The Kansas City Federal Reserve published a presentation on April 3, 2008 showing that average interchange fee rates rose from less than 1.3% to more than 1.6% between 1996 and 2005. And, according to Kansas City Federal Reserve economists, that rate is nearly 2% today. The American Banker on March 1, 2006 reported on Visa's "long-standing pattern of regular increases" in its interchange fees and said that "According to the credit card industry newsletter The Nilson Report, interchange rates for Visa and MasterCard International have risen steadily every year since 1997." At the same time, transaction volume has increased dramatically, so the absolute amount of interchange fees collected rose even more dramatically. And, credit card companies have consistently moved more cardholders to new corporate and rewards cards that carry higher interchange fee rates. While they sometimes don't change the rates for a given

[12] "Trickle Up Wealth Transfer: Cross-subsidization in the payment card market," The Hispanic Institute, November 2009 at 6.

[13] GAO Report at 14 (emphasis added).

type of card – that doesn't matter if many of the people who had been using that card are now using a card with a higher rate. By moving people to rewards cards, the card companies continue to pretend that they don't raise rates even though the rates merchants pay for interchange consistently increase. The combination of all of these factors means that since 2001, the amount of interchange collected has tripled from $16 billion to $48 billion in 2008.

Myth: *There is no need for reform because merchants can simply stop accepting credit cards.*

Reality: Economists have found that due to the market power of Visa and MasterCard, this is not true. This argument would be like AT&T claiming in the 1980s that no one should worry about its monopoly because people could choose not to have a telephone. Accepting cards is essential for most businesses. The Kansas City Federal Reserve studied this issue in a 2004 report titled, "A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?" and concluded, "Only monopoly merchants who are facing an inelastic consumer demand may deny cards when the fee exceeds its transactional benefit. . . Merchant competition allows the network to set higher merchant fees. The network can always set higher merchant fees in more competitive markets. Moreover, in competitive markets the merchant fees in the long run may exceed the sum of the merchant's initial margin and the merchant's transactional benefit. . . . As long as the merchant fee does not exceed the level that gives merchants negative profits, merchants may have no choice but to continue accepting cards." The courts also agree that Visa and MasterCard both have market power which means they have the ability to raise their prices above what would be sustained in a competitive market.[14]

Myth: *Efforts to reform the interchange fee system are nothing more than government price control proposals.*

Reality: There is absolutely nothing in the Conyers-Shuster bill that sets the amount of interchange. The only things the bill does, as I have noted, is allow for collective bargaining. If leveling the playing field so that negotiations can occur impacts the cost of interchange, that is what ought to happen.

Myth: *Reform will hurt consumers and result in them paying higher fees.*

Reality: Policymakers around the world have found that reform has benefited consumers. In Australia, for example, the Reserve Bank of Australia reviewed the interchange reforms instituted there and concluded, "Overall, consumers are benefiting from this greater competition and lower merchant costs . . . one group of consumers clearly better off are those who regularly borrow on their credit cards. <u>They are now able to obtain a card with an interest rate of 10 to 13 per cent, rather than the</u>

[14] *U.S. v. Visa U.S.A., Inc.*, 344 F. 3d 229 (2d Cir. 2003).

16 to 18 per cent payable on traditional cards. For many consumers the resulting savings can run into hundreds of dollars per year . . . Consumers who do not use credit cards at all are also benefiting from the reforms as they are paying lower prices for goods and services than would otherwise have been the case. For many years, these consumers have helped subsidise the generous reward points of the credit card issuers through paying higher prices for goods and services. The reforms have helped unwind some of this subsidy."[15] The Reserve Bank of Australia reconfirmed this view in 2008 when it wrote, "One issue that has attracted considerable attention since the reforms were introduced is whether the cost savings that merchants have received from lower merchant service fees have been passed on to consumers in the form of lower prices for goods and services than would have otherwise been the case. The [card] schemes argue that there has been no, or little, pass-through, while the merchants argue that the cost savings have been passed through. The Bank's estimate is that over the past year, these cost savings have amounted to around $1.1 billion . . . . Despite the difficulties of measurement, the Board's judgement remains that the bulk of these savings have been, or will eventually be, passed through into savings to consumers. This judgement is consistent with standard economic analysis which suggests that, ultimately, changes in business costs are reflected in the prices that businesses charge. A similar conclusion was reached by the House of Representatives Standing Committee on Economics, Finance and Public Administration when it considered the Bank's payments system reforms in 2006."[16]

The credit card industry has repeatedly stated, or perhaps threatened, that lower interchange fees will mean higher consumer credit card fees. This argument has been thoroughly researched and rejected. As noted previously, for example, the European Commission's Directorate of Competition reviewed this claim and found, "There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee would have to be compensated with higher cardholder fees."

The flip-side of this argument proves its shallowness. Interchange fees in the United States have tripled since 2001 – have consumer credit card fees been cut by one-third? Absolutely not. Simply asking the question makes the absurdity obvious. In fact, consumer card fees have been rising too. Credit card fees are not a zero sum game in which the industry has a God-given right to a set amount of revenue – as they would like you to believe – but instead are a reflection of the card industry's insatiable hunger for fees aided by their unfair and deceptive practices in charging them.

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[15] Payments System Board Annual Report, *Reserve Bank of Australia*, 2005 at 14.

[16] Reform of Australia's Payment System: Preliminary Conclusions of the 2007/2008 Review, *Reserve Bank of Australia*, at 23.

Myth: *These reforms will make it more complicated for consumers. The current system works well for them.*

Reality: The current system fools consumers by hiding the large interchange fees that are built into the cost of their purchases. To quote one of my fellow witnesses today, Ed Mierzwinski of U.S. PIRG, "Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers basically subsidize credit card usage by paying inflated prices – prices inflated by the billions of dollars of anticompetitive interchange fees. And unfortunately, those credit card interchange fees continue to accelerate, because there is nothing to restrain Visa and MasterCard from charging consumers and merchants more."[17] In addition, consumer groups including the Consumer Federation of America, Consumer's Union, and Consumer Action have all submitted Congressional testimony criticizing the current system of interchange fees because it is not fair to consumers.

Economists with the Kansas City Federal Reserve Bank appear to agree with consumer groups on some of the problems with the current system for consumers. In a 2006 working paper titled "Payment Card Rewards Programs and Consumer Payment Choice," they wrote that "rewards programs and the accompanied merchant fee structure may work as tools that distribute income from low-income earners to high-income earners." That is, of course, just what the Hispanic Institute found in its study published in November.

In addition, the European Commission has found that interchange fees harm consumers. In December 2007, the Commission found MasterCard's multilateral interchange fee illegal and Competition Commissioner Neelie Kroes said that interchange "inflated the cost of card acceptance by retailers without leading to any advantage for consumers or retailers. On the contrary, consumers foot the bill, as they risk paying twice for payment cards. Once through annual fees to their bank. And a second time through inflated retail prices . . ." Kroes concluded that MasterCard's interchange "acts like a 'tax on consumption' paid not only on card users but also by consumers using cash and cheques."

Myth: *Interchange is needed to balance the two sides of the card market consumers and merchants so that the system is used by more people and better benefits everyone.*

Reality: This rationale has been firmly rejected. European regulators have investigated this claim in-depth and concluded that it is inconsistent with the facts and does not

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[17] Testimony of Ed Mierzwinski before the House Judiciary Committee Antitrust Task Force, May 15, 2008.

create an economic efficiency that makes up for the problems created by the lack of price competition between member banks in the setting of interchange fees.[18] Interchange is a charge imposed by Visa, MasterCard and their member banks – not a mystical balancing mechanism. When Australia moved to regulate rates (after Visa and MasterCard rejected attempts to address the antitrust problems with the system), the card associations argued that regulation would kill the card system. It hasn't happened. Card use is at an all-time high in Australia in spite of Visa and MasterCard's protestations and the banks are competing to offer consumers lower interest rates. Once reformed, the credit card system in the United States will continue to flourish.

Myth: *When Australia took regulatory action in this area it resulted in consumers paying more for credit cards and hurt the credit system.*

Reality: When Australia acted, MasterCard said it would mean the end of the credit card system in that nation. They were wrong. More consumers use more cards for less than ever before in Australia. In fact, rather than Visa and MasterCard competing to raise interchange fees so that banks will issue more of their cards, they have had to give consumers what they really wanted – lower interest rates on their cards. This interest rate competition has benefitted consumers immensely. The only ones who don't like it are Visa and MasterCard (and their member banks) because they don't make as much on interchange fees and must now compete more thoroughly on the value they deliver to consumers. The Reserve Bank of Australia reviewed the interchange reforms instituted there and concluded, "Overall, consumers are benefiting from this greater competition and lower merchant costs . . . one group of consumers clearly better off are those who regularly borrow on their credit cards. <u>They are now able to obtain a card with an interest rate of 10 to 13 per cent, rather than the 16 to 18 per cent payable on traditional cards</u>. For many consumers the resulting savings can run into hundreds of dollars per year . . . <u>Consumers who do not use credit cards at all are also benefiting from the reforms as they are paying lower prices for goods and services than would otherwise have been the case.</u> For many years, these consumers have helped subsidise the generous reward points of the credit card issuers through paying higher prices for goods and services. The reforms have helped unwind some of this subsidy."[19] It should be noted that the credit card companies have funded studies that have a different view of the reforms in Australia. Merchants have funded their own studies, but we think the Reserve Bank's findings are the most authoritative source and urge everyone on the Committee to read them when making their judgments – and not listen to how they are characterized (and often mischaracterized) by others.

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[18] See December 19, 2007 Antitrust Ruling of the European Commission.

[19] Payments System Board Annual Report, *Reserve Bank of Australia*, 2005 at 14.

Myth: *Credit and debit cards provide a valuable service for merchants and consumers, but merchants do not want to pay a fair price for that service.*

Reality: Credit and debit cards do provide a service. Just as was the case with the old AT&T, the problem is that the interchange fee system now violates the antitrust laws and is so riddled with unfair rules that keep any competition from entering the system that it must be reformed. Under the Conyers-Shuster bill, there will still be interchange – it will just be charged in a system where some small measure of competition and transparency will exist. Once reformed, not only will there be interchange fees, but there will still be processing fees and merchants will have to pay any fees associated with maintaining their accounts at their local banks. And, of course, credit card companies will still charge consumers an array of interest charges and fees. While credit card companies will not like reform, they will continue to have many avenues to recover costs, compete, and make profits, but they will have to do so in a transparent system so that consumers and merchants have real choices about the payment services they use and the costs they incur.

Myth: *Banks need high interchange in order to recover the costs of fraud and guarantee payment to merchants.*

Reality: Economists with the Federal Reserve Bank of Kansas City have found that fraud costs are not a justification for over-inflated interchange fees. They wrote, "Card organizations have often argued that the reason why they impose proportional fees stems from the cost they bear from their "payment guarantee" service which insures merchants against customers who pay with cards without having sufficient funds. We argue that the cost of fraud and insufficient funding is negligible compared with fees at the range of 1% to 3% commonly imposed by brand name cards. For example, industry studies show that the average net fraud losses are around 0.05% for signature debit cards, which do not extend credit to card users."[20]

Even if banks issuing cards paid out more in fraud, however, that would not justify them charging the merchants for this. While the card companies claim that they guarantee payment to merchants, in reality this "guarantee" is nothing more than a promise to pay when they want to pay. Both Visa and MasterCard have pages and pages of rules for situations in which they can "chargeback" the amount of a transaction to the merchant. These chargebacks are so common that in actuality U.S. merchants absorb more of the cost of fraud each year than the banks that issue the cards. A 2009 study from LexisNexis in conjunction with Javelin Strategy & Research found that merchants absorb nearly ten times the cost of fraud that the banks absorb each year.[21]

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[20] "Why Do Card Issuers Charge Proportional Fees?" Oz Shy and Zhu Wang, December 2008 at 3.

[21] 2009 LexisNexis True Cost of Fraud Study at 23.

One recent example demonstrates in microcosm why this is the case. Exhibit 5 to this testimony is a letter from the owner of the The Catch Seafood Tavern in Port Jefferson, New York to his representatives in Congress. It details his recent experience with the card companies. He had five chargebacks in a month that meant the bank took $78 in sales from him. He argued successfully that each chargeback was in fact a valid transaction and that he should get his money. Finally, the bank agreed with him, but charged him a fee of $15.50 per chargeback. So, he received his $78 but then was charged a total of $77.50 in fees. Obviously, this didn't amount to any kind of guarantee at all. This type of behavior is blatantly unfair, amounts to a license for the banks to take merchants' money, and happens frequently. It demonstrates another reason why large interchange fees cannot be justified and must be reformed.

Exhibit 1

Oil Express

Recognizing new tribes could mean new tax losses, marketers warn

Branded jobbers and truck stop marketers are pleading with Congress not to extend federal recognition to two Indian tribes without first ensuring a continued competitive marketplace for motor fuels and tobacco.

Rep. Jim Moran (D-VA) is pushing a bill to recognize the Rappahannock Indian and Thomasina E. Jordan tribes in Virginia. Federal recognition would confer sovereign status on the tribes, allowing them to take into trust some of Virginia's most populous counties.

Sovereign status also allows tribes to sell fuel and tobacco to members without remitting state tax, but some flout the rules by failing to collect taxes from non-tribal members too. The result has been huge revenue losses in some states. New York estimates it has lost nearly $4 billion in cigarette excise taxes alone since 1995, while Oklahoma believes state tobacco taxes are under-collected by roughly $4 million/mo.

"While the state loses tax revenue, many motor fuel marketers and truck stop operators are losing their livelihood and their ability to compete in the marketplace," say the Petroleum Marketers Assn. of America and the National Assn. of Truck Stop Operators.

In Virginia, state excise tax is 17.5cts/gal on gasoline and 18cts/gal on diesel. In 2005, the average gross margin for retailers was 15.1 cts/gal and 15.5cts/ gal, respectively. By failing to remit state taxes, Indian tribes gain a price edge that is greater than many retailers' gross margins, the groups said in an April 16 letter to Rep. Nick J. Rahall (D), chairman of the House Natural Resources Committee. Congress should add language to Moran's bill that would make federal recognition of the tribes conditional on their compliance with all state excise tax requirements, they say.

State won't intervene in dispute between Visa and marketers

Visa to marketers: If you don't like our rules, don't offer discount-for-cash

State regulators in California won't come to the rescue of marketers caught between obeying state standards on discount-for-cash pricing and demands by Visa that they drop the word 'credit' from price signs.

"As far as we're concerned, putting the word 'credit' on a price sign is appropriate, but as far as Visa telling marketers they can't do it, that's a civil matter between Visa and the marketers," says Dennis Johannes, the state's Weights and Measures director. "We have no authority to regulate Visa."

The state's posture leaves marketers in a Catch 22 situation. If they use the word 'credit,' Visa has said it may fine them and strip them of their right to take Visa cards. But if they adopt some of Visa's suggestions, such as leaving the 'credit' sign blank, they will be violating state standards, says Johannes.

Johannes believes that Visa is being "a little heavy-handed" on the issue. "They probably don't want dual pricing because it discourages the use of their credit card," he says. His only suggestion for marketers is that they seek a legislative change that will specifically require the use of the word 'credit' on signage.

Johannes is not alone in his suspicions of Visa's motives.

"Visa's goal is to get everyone to pay the higher, credit card price for fuel and they will twist and torture their rules if necessary to force consumers to do so," says Mallory Duncan, chairman of the Merchants Payments Coalition, a business group dedicated to fighting for lower card interchange rates.

Visa is not particularly sympathetic to the plight of marketers – the credit card giant says it is the marketers' fault for offering discount-for-cash in the first place.

"If the merchant wants to steer the consumer to discount for cash, then they have to do it within the context of Visa's rules," said Visa spokeswoman Rhonda Bentz. "It's great if they have a contract with the state, but they don't. They have a contract with Visa and if they don't want to abide by that contract, they shouldn't have signed it," she said.

"These merchants clearly want the consumer to pay with cash. Okay, then, they should just accept cash and not credit cards. But they want access to our 1 billion cardholders, and they want the reduced risk that comes with taking Visa, and they want the guaranteed payments. They just don't want to pay for it."

Visa threatened to fine Mom and Pop operator Mike Gharib's credit card processor $5,000 because he was using the word 'credit' on his price sign, as exclusively reported (OE 04/16). The processor, Petroleum Card Services, planned to pass the fine through to Gharib. Visa withdrew the threat after Oil Express raised questions on the issue. The company says Gharib is now "compliant" with its rules. Gharib has removed the word 'credit' and that part of his price sign is now blank, Oil Express sources say.

Visa's position is that the higher price next to the word 'credit' on signs implies that the customer is paying a surcharge for credit, which is against Visa rules. It wants marketers to substitute other terms, such as 'regular' or 'standard,' or just leave that part of the sign blank. Additionally, Visa says the word 'credit' does not take into account debit cards, which must be treated the same as cash sales under state regulations. Therefore, the signs are misleading to debit customers, too, says Bentz.

Asked why Visa should start objecting to the word 'credit' after its use on station signs for 26 years, Bentz says Visa received complaints from consumers who thought they were being surcharged for credit.

Johannes says consumers know debit transactions are the same as cash, and that the difference between the two forms of payment – cash and credit – is well-understood. Using the term 'standard' or 'regular' would confuse customers, and leaving the sign blank would violate state rules. Visa's other suggestions – 'non-cash' and 'base price' – would have to be studied, he says.

"'Non-cash' is probably something we would not pursue as being illegal but there are a lot of other enforcement people in this state, such as the district attorney, county officials, and state attorney general's office, and we don't speak for them."

Visa has also objected to the way some marketers handle debit card sales at the pump and there is a suspicion among some marketer groups that the company would like to force consumers to go into the station to sign for a debit card transaction. Visa receives higher fees for debit signature sales than it does for Personal Identification Number transactions, sources say.

Visa has told Auburn, Calif.-based marketer Nella Oil that its debit card sales at the pump violate Visa rules because those customers are not getting the cash or discount price.

When customers use a Visa debit card at the pump, they are required to enter a PIN. If they do not do so, the card processor treats the sale as a credit card transaction and the customer will pay the higher, credit price for fuel. Likewise, the marketer will pay the higher fees associated with credit card transactions, although the money will ultimately be debited from the customer's bank account.

Nella has decals on its pumps clearly warning customers that they must key in their PIN to get the debit price, and the state has approved that decal, a Nella exec says. Visa says that's not enough to ensure that customers receive their cash discounts. Nella had hoped to get its bank to segregate PIN debit purchases and block them at the pump, but has been told that is not possible. "So, we're back to square one," says Nella.

Actually, not quite – under the landmark Wal-Mart-Visa lawsuit settlement, Visa and MasterCard were barred from bundling their debit and credit cards together, so forcing merchants to accept debit cards whether they wanted to or not.

Nella can write to its card processor or bank and tell them that it no longer wishes to accept Visa debit cards, says an industry lawyer. This will cause the bank to shut off Nella's access to the Visa debit network. As a result, when a customer swipes his debit card the sale will be routed automatically to the regional debit network whose logo appears on the back of the Visa card – the Star network would be one such example. The Star system will not process the customer's sale until he inputs his PIN, so avoiding charging him the credit card price for fuel.

"What's so frustrating is that Visa and MasterCard have a duopoly in the market place and they're trying to put retailers in an untenable position in order to increase their leverage and revenues," says Duncan, with the Merchants Payments Coalition.

Exhibit 2

FORTUNE 500 *Our annual ranking of America's largest corporations* 2009

Full List | Near You | CEOs | Top Companies | Top Industries

Fastest growers | Most profitable | Most bang for buck | Best investments | All industries

Top industries: Most profitable

RETURN ON REVENUES | RETURN ON ASSETS | RETURN ON SHAREHOLDERS' EQUITY

Industry Rank	Industry	2008 Profits as % of Revenues
1	Network and Other Communications Equipment	20.4
2	Internet Services and Retailing	19.4
3	Pharmaceuticals	19.3
4	Medical Products and Equipment	16.3
5	Railroads	12.6
6	Financial Data Services	11.7
7	Mining, Crude-Oil production	11.5
8	Securities	10.7
9	Oil and Gas Equipment, Services	10.2
10	Scientific, Photographic, and Control Equipment	9.9
11	Household and Personal Products	8.7
12	Utilities: Gas and Electric	8.7
13	Aerospace and Defense	7.6
14	Food Services	7.1
15	Industrial Machinery	6.9
16	Food Consumer Products	6.7
17	Electronics, Electrical Equipment	6.5
18	Commercial Banks	5.2
19	Telecommunications	5.1
20	Chemicals	5.0
21	Construction and Farm Machinery	5.0
22	Insurance: Life, Health (stock)	4.6

23	Information Technology Services	4.5
24	Computers, Office Equipment	4.3
25	Metals	3.9
26	Wholesalers: Diversified	3.5
27	Insurance: Property and Casualty (stock)	3.3
28	Specialty Retailers	3.2
29	General Merchandisers	3.2
30	Health Care: Pharmacy and Other Services	3.0
31	Packaging, Containers	3.0
32	Beverages	2.9
33	Engineering, Construction	2.7
34	Health Care: Medical Facilities	2.4
35	Health Care: Insurance and Managed Care	2.2
36	Petroleum Refining	2.1
37	Food and Drug Stores	1.5
38	Pipelines	1.5
39	Wholesalers: Health Care	1.3
40	Semiconductors and Other Electronic Components	1.0
41	Energy	0.9
42	Home Equipment, Furnishings	0.7
43	Food Production	0.6
44	Wholesalers: Electronics and Office Equipment	-0.3
45	Diversified Financials	-0.6
46	Motor Vehicles and Parts	-0.7
47	Insurance: Life, Health (mutual)	-3.0
48	Hotels, Casinos, Resorts	-4.5
49	Automotive Retailing, Services	-7.9
50	Forest and Paper Products	-9.6
51	Entertainment	-10.0
52	Real Estate	-13.4

53	Airlines	-13.5

Issue date: May 4, 2009

FORTUNE 500 *Our annual ranking of America's largest corporations* 2008

Full List | Near You | CEOs | Top Companies | **Top Industries**

Fastest growers | Most profitable | Most bang for buck | Best investments | All industries

Top industries: Most profitable

RETURN ON REVENUES | RETURN ON ASSETS | RETURN ON SHAREHOLDERS' EQUITY

Industry Rank	Industry	2007 Profits as % of Revenues
1	Network and Other Communications Equipment	28.8
2	Mining, Crude-Oil Production	23.8
3	Pharmaceuticals	15.8
4	Medical Products and Equipment	15.2
5	Oil and Gas Equipment, Services	13.7
6	Commercial Banks	12.6
7	Railroads	12.4
8	Entertainment	12.4
9	Insurance: Life, Health (stock)	10.6
10	Household and Personal Products	10.2
11	Securities	10.1
12	Insurance: Property and Casualty (stock)	9.9
13	Real Estate	9.9
14	Scientific, Photographic, and Control Equipment	9.8
15	Financial Data Services	8.7
16	Food Services	7.9
17	Publishing, Printing	7.9
18	Utilities: Gas and Electric	7.9
19	Industrial and Farm Equipment	7.6
20	Electronics, Electrical Equipment	7.6
21	Hotels, Casinos, Resorts	7.3
22	Aerospace and Defense	7.2

23	Beverages	7.2
24	Chemicals	7.0
25	Internet Services and Retailing	7.0
26	Food Consumer Products	6.5
27	Telecommunications	6.4
28	Health Care: Insurance and Managed Care	6.2
29	Petroleum Refining	6.2
30	Computers, Office Equipment	6.0
31	Metals	5.5
32	Packaging, Containers	5.5
33	Home Equipment, Furnishings	5.3
34	Wholesalers: Diversified	4.3
35	Specialty Retailers	3.8
36	Information Technology Services	3.8
37	Energy	3.7
38	Airlines	3.6
39	General Merchandisers	3.5
40	Health Care: Medical Facilities	3.3
41	Pipelines	3.1
42	Engineering, Construction	2.8
43	Health Care: Pharmacy and Other Services	2.6
44	Food and Drug Stores	2.1
45	Wholesalers: Electronics and Office Equipment	1.6
46	Automotive Retailing, Services	1.1
47	Wholesalers: Health Care	1.1
48	Motor Vehicles and Parts	1.1
49	Food Production	1.0
50	Semiconductors and Other Electronic Components	0.6
51	Diversified Financials	-0.9
52	Homebuilders	-9.5

FORTUNE 500 | 2007

Our annual ranking of America's largest corporations

Full list	Companies	States	Industries	CEOs
Top performers	Employers	Cities	Women CEOs	Climbers
Arrivals	Exits	Losers	50/50	FAQ

Top industries

Most Profitable Industries: Return on Revenues

Revenues | Assets | Shareholder equity

Industry Rank	Industry	2006 Profits as % of Revenues
1	Mining, Crude-Oil Production	26.6
2	Pharmaceuticals	19.6
3	Commercial Banks	16.2
4	Financial Data Services	15.2
5	Network and Other Communications Equipment	14.0
6	Medical Products & Equipment	13.5
7	Railroads	13.1
8	Securities	12.4
9	Publishing, Printing	12.4
10	Insurance: P & C (stock)	11.8
11	Diversified Financials	10.9
12	Insurance: Life, Health (stock)	10.7
13	Entertainment	10.7
14	Internet Services and Retailing	10.5
15	Oil and Gas Equipment, Services	10.4
16	Household and Personal Products	9.2
17	Metals	8.0
18	Food Services	7.9
19	Semiconductors and Other Electronic Components	7.7
20	Petroleum Refining	7.3
21	Industrial & Farm Equipment	7.2
22	Homebuilders	7.1
23	Hotels, Casinos, Resorts	7.0
24	Utilities: Gas & Electric	6.8
25	Beverages	6.6

FORTUNE 500 Headquarters

Click to enlarge

Show FORTUNE 500 Companies:
Top 50 | 25 Most profitable | Full list

What readers say...

- Everyone talks of America is a failing Democracy... WHAT? First...
- For those who have commented on Sam Walton's philosophy being...
- Now, consider this. WalMart no longer has Sam Walton running it.The...

Have your say

GALLERY

Top 50

Wal-Mart retakes the No. 1 slot on the Fortune 500 this year. See where America's largest companies rank, and why.

See them all

GALLERY

26	Chemicals	6.6
27	Computers, Office Equipment	6.5
28	Electronics, Electrical Equipment	6.4
29	Apparel	6.3
30	Telecommunications	6.2
31	Food Consumer Products	5.9
32	Aerospace and Defense	5.9
33	Health Care: Insurance & Managed Care	5.8
34	Packaging, Containers	4.3
35	Wholesalers: Diversified	4.1
36	Health Care: Medical Facilities	3.9
37	Specialty Retailers	3.6
38	General Merchandisers	3.3
39	Health Care: Pharmacy and Other Services	2.8
40	Food & Drug Stores	2.6
41	Airlines	2.6
42	Energy	2.6
43	Information Technology Services	2.2
44	Engineering, Construction	1.7
45	Pipelines	1.7
46	Wholesalers: Food and Grocery	1.7
47	Wholesalers: Electronics and Office Equipment	1.4
48	Automotive Retailing, Services	1.2
49	Wholesalers: Health Care	0.9
50	Food Production	-0.7
51	Motor Vehicles & Parts	-1.4

From the April 30th, 2007 issue

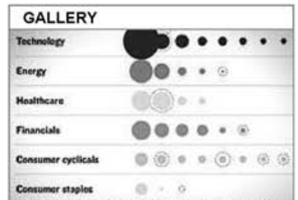
Note:
Due to slight differences in rounding, industry data online may not exactly match the FORTUNE 500 magazine version.

PHOTOS FROM COMPANY WEBSITES

Best employers

More than 35 companies are on both the 2007 Fortune 1000 and 100 Best Companies to Work For lists.
See them all

GALLERY



INTERACTIVE GRAPHIC BY MACAULAY CAMPBELL

Big deals

Last year saw the biggest buyout frenzy since 2000, as 42 Fortune 1,000 corporations were acquired. Who was part of the buyout binge?
See them all

FORTUNE 500 2006

Our annual ranking of America's largest corporations

Full list	Companies	States	Industries	CEOs
Top performers	Employers	Cities	Women CEOs	Climbers
Arrivals	Exits	Losers	50/50	FAQ

Top industries

Most Profitable Industries: Return on Revenues

Industry Rank	Industry	2005 Profits as % of Revenues
1	Mining, Crude-Oil Production	29.9
2	Internet Services and Retailing	23.8
3	Commercial Banks	18.3
4	Network and Other Communications Equipment	15.8
5	Pharmaceuticals	15.7
6	Medical Products & Equipment	13.2
7	Securities	12.7
8	Railroads	12.5
9	Diversified Financials	12.4
10	Publishing, Printing	11.8
11	Household and Personal Products	11.1
12	Insurance: Life, Health (stock)	10.3
13	Homebuilders	9.9
14	Insurance: P & C (stock)	9.0
15	Oil and Gas Equipment, Services	8.7
16	Entertainment	8.4
17	Food Consumer Products	8.4
18	Electronics, Electrical Equipment	8.2
19	Food Services	8.0
20	Computers, Office Equipment	7.5
21	Health Care: Insurance & Managed Care	7.1
22	Hotels, Casinos, Resorts	6.8
23	Industrial & Farm Equipment	6.6
24	Apparel	6.5
25	Petroleum Refining	6.1
26	Utilities: Gas & Electric	6.0

27	Chemicals	5.8
28	Metals	5.6
29	Beverages	5.3
30	Information Technology Services	5.1
31	Aerospace and Defense	4.9
32	Health Care: Medical Facilities	4.6
33	Telecommunications	4.2
34	General Merchandisers	4.1
35	Specialty Retailers	4.0
36	Semiconductors and Other Electronic Components	3.9
37	Energy	3.0
38	Food Production	2.8
39	Health Care: Pharmacy and Other Services	2.8
40	Wholesalers: Diversified	2.3
41	Engineering, Construction	2.2
42	Wholesalers: Food and Grocery	2.1
43	Food & Drug Stores	1.6
44	Pipelines	1.4
45	Wholesalers: Electronics and Office Equipment	1.4
46	Wholesalers: Health Care	1.3
47	Automotive Retailing, Services	1.1
48	Motor Vehicles & Parts	1.1
49	Packaging, Containers	0.4
50	Airlines	-10.6

From the April 17th, 2006 issue

Exhibit 3

Table IV.7: Profitability of Large Retail Corporations,* 2003–2007 (NAICS Definitions, Millions of Dollars, and Percent)

- **Retail industry profitability tends to average between 2 and 4 percent, a relatively low rate compared to profitability in other industries, such as manufacturing.**
- **Increased purchases during the holiday shopping season make the fourth quarter the most important quarter for retailers in terms of profitability.**
- **After steadily climbing for the last several years, retail industry profitability dropped slightly in 2007 to 3.02%.**

	Profits After Income Taxes	Net Sales Receipts & Operating Revenues	Retail Profits as a Share of Sales
2003	**$45,364**	**$1,524,730**	**2.98%**
1st quarter	11,283	354,328	3.18
2nd quarter	9,656	364,426	2.65
3rd quarter	9,518	377,950	2.52
4th quarter	14,907	428,026	3.48
2004	**$53,186**	**$1,666,495**	**3.19%**
1st quarter	11,429	394,605	2.90
2nd quarter	13,572	405,436	3.35
3rd quarter	11,186	409,756	2.73
4th quarter	16,999	456,698	3.72
2005	**$56,281**	**$1,791,228**	**3.14%**
1st quarter	12,307	426,016	2.89
2nd quarter	13,154	441,328	2.98
3rd quarter	13,076	445,043	2.94
4th quarter	17,744	478,841	3.71
2006	**$63,174**	**$1,948,397**	**3.24%**
1st quarter	15,479	459,382	3.37
2nd quarter	13,827	477,908	2.89
3rd quarter	14,068	479,348	2.93
4th quarter	19,800	531,759	3.63
2007	**$62,344**	**$2,066,429**	**3.02%**
1st quarter	14,370	497,962	2.89
2nd quarter	17,648	512,116	3.45
3rd quarter	12,887	504,138	2.56
4th quarter	17,439	552,213	3.16

* Retailers with assets of $50 million and over.

Source: Derived from U.S. Department of Commerce, Bureau of the Census data.

Exhibit 4

Share of Interchange Collected by Card Type

Credit Card Interchange

Sources: Nilson, #918, #919, #923
Federal Reserve Bank of Kansas City

Rank	Issuer	% Interchange Market	Running Share
1	JPMorgan Chase	24.9%	24.9%
2	Bank of America	18.3%	43.2%
3	Citigroup	15.6%	58.8%
4	Capital One	6.4%	65.2%
5	U.S. Bank	4.9%	70.1%
6	Wells Fargo	3.2%	73.3%
7	HSBC	2.8%	76.1%
8	USAA Savings	2.0%	78.0%
9	Barclays	1.7%	79.7%
10	PNC Bank	0.9%	80.7%
11	Target	0.9%	81.6%
12	Advanta	0.8%	82.4%
13	First National	0.6%	83.0%
14	Navy FCU	0.4%	83.4%
15	GE Money	0.4%	83.8%
16	Nordstrom	0.4%	84.2%
17	Fifth Third Bank	0.3%	84.6%
18	RBS Citizens	0.3%	84.9%
19	SunTrust Bank	0.3%	85.2%
20	BB&T	0.3%	85.5%
21	Comdata	0.3%	85.8%
22	State Farm Bank	0.3%	86.1%
23	ICBA Bancard	0.3%	86.4%
24	Cabela's WFB	0.2%	86.6%
25	Commerce Bank	0.2%	86.8%
26	TIB-The Ind. Bankers	0.2%	86.9%
27	Pentagon FCU	0.1%	87.1%
28	Town North Bank	0.1%	87.2%
29	First Hawaiian Bank	0.1%	87.3%
30	M&I Bank	0.1%	87.5%
31	BECU	0.1%	87.5%
32	First Premier	0.1%	87.6%
33	CompuCredit	0.1%	87.7%
34	Credit One Bank	0.1%	87.8%
35	First Citizens Bank	0.1%	87.9%
36	Columbus B&T	0.1%	88.0%
37	Zions Bancorporation	0.1%	88.0%
38	1st Financial Bank	0.1%	88.1%
39	UMB	0.1%	88.2%
40	Digital FCU	0.1%	88.2%
41	First Horizon	0.1%	88.3%
42	BMW Bank	0.1%	88.4%
43	Merrick Bank	0.1%	88.4%
44	Compass Bank	0.1%	88.5%
45	America First CU	0.1%	88.5%
46	TD Bank	0.0%	88.6%
47	RBC Centura	0.0%	88.6%
48	Silverton Bank	0.0%	88.7%
49	SchoolsFirst FCU	0.0%	88.7%
50	Suncoast Schools FCU	0.0%	88.8%

Share of Interchange Collected by Card Type

Credit Card Interchange - Continued

Rank	Issuer	% Interchange Market	Running Share
51	San Diego County CU	0.0%	88.8%
52	Golden 1 CU	0.0%	88.8%
53	Pa. State. Empl.	0.0%	88.9%
54	State Employees CU	0.0%	88.9%
55	Simmons First Nat'l	0.0%	88.9%
56	Redstone FCU	0.0%	89.0%
57	Wescom CU	0.0%	89.0%
58	VyStar CU	0.0%	89.0%
59	Arvest Bank Group	0.0%	89.1%
60	Intrust Bank	0.0%	89.1%
61	Randolph-Brooks FCU	0.0%	89.1%
62	Baxter CU (BCU)	0.0%	89.1%
63	First Tech CU	0.0%	89.2%
64	Delta Community CU	0.0%	89.2%
65	Tower FCU	0.0%	89.2%
66	Patelco CU	0.0%	89.2%
67	Farm Bureau Bank	0.0%	89.3%
68	Mission FCU	0.0%	89.3%
69	BancorpSouth	0.0%	89.3%
70	Wash. State Empl.	0.0%	89.3%
71	FirstMerit Bank	0.0%	89.3%
72	Affinity FCU	0.0%	89.4%
73	United Nations FCU	0.0%	89.4%
74	Mountain America CU	0.0%	89.4%
75	Arizona FCU	0.0%	89.4%
76	Police & Fire	0.0%	89.4%
77	GTE FCU	0.0%	89.4%
78	Alaska USA FCU	0.0%	89.5%
79	Mich. State Univ.	0.0%	89.5%
80	Citizens Equity First	0.0%	89.5%
81	Kinecta FCU	0.0%	89.5%
82	Bellco CU	0.0%	89.5%
83	Security Service FCU	0.0%	89.5%
84	Associated Bank	0.0%	89.5%
85	Travis CU	0.0%	89.6%
86	Virginia CU	0.0%	89.6%
87	State Empl. CU	0.0%	89.6%
88	Anheuser Busch CU	0.0%	89.6%
89	Tinker FCU	0.0%	89.6%
90	Hudson Valley FCU	0.0%	89.6%
91	Educa. Employ. CU	0.0%	89.6%
92	Alliant CU	0.0%	89.6%
93	Kern Schools FCU	0.0%	89.6%
94	Lockheed FCU	0.0%	89.6%
95	American Svgs. Bank	0.0%	89.7%
96	ESL FCU	0.0%	89.7%
97	Redwood CU	0.0%	89.7%
98	SAFE CU	0.0%	89.7%
99	South Carolina FCU	0.0%	89.7%
100	Municipal CU	0.0%	89.7%

Share of Interchange Collected by Card Type

Signature Debit Card Interchange

Sources: Nilson, #918, #919, #923
Federal Reserve Bank of Kansas City

Rank	Issuer	% Interchange Market	Running Share
1	Bank of America	15.4%	15.4%
2	Wells Fargo V	12.1%	27.5%
3	JPMorgan Chase V/MC	9.7%	37.2%
4	U.S. Bank	2.9%	40.1%
5	PNC V	2.5%	42.6%
6	USAA	2.0%	44.6%
7	FIfth Third V/MC	1.7%	46.3%
8	TD Bank V	1.5%	47.8%
9	SunTrust V	1.5%	49.3%
10	Regions Bank	1.5%	50.8%
11	Citizens Bank	1.5%	52.3%
12	Citibank	1.4%	53.7%
13	Navy FCU	1.2%	54.9%
14	BB&T V	1.1%	56.0%
15	MetaBank V/MC/D	0.8%	56.8%
16	Capital One V/MC	0.8%	57.7%
17	TCF Financial V	0.8%	58.4%
18	M&T Bank V/MC	0.7%	59.1%
19	E*Trade Bank V	0.7%	59.8%
20	ICBA Bancard V/MC	0.6%	60.4%
21	Huntington Nat'l	0.6%	61.0%
22	KeyBank MC	0.6%	61.6%
23	Compass Bank V	0.6%	62.1%
24	Sovereign Bank V	0.5%	62.6%
25	HSBC MC 30	0.4%	63.0%
26	Bank of the West	0.4%	63.5%
27	State Empl. CU, NC	0.4%	63.9%
28	Harris N.A. MC	0.3%	64.2%
29	Zions Bancorp. V	0.3%	64.5%
30	Commerce Bank Mo.	0.3%	64.8%
31	Union Bank Calif.	0.3%	65.1%
32	Arvest Bank V	0.2%	65.3%
33	Comerica Bank V/MC	0.2%	65.5%
34	Town North V/MC	0.2%	65.8%
35	FirstBank Colo. V	0.2%	66.0%
36	Associated Bank MC	0.2%	66.2%
37	First Horizon V	0.2%	66.4%
38	M&I Bank V	0.2%	66.6%
39	BOK Financial V	0.2%	66.8%
40	Synovus V 39	0.2%	67.0%
41	FirstMerit Bank V	0.2%	67.2%
42	First Citizens N.C.	0.1%	67.4%
43	BECU MC 37	0.1%	67.5%
44	People's United	0.1%	67.6%
45	BancorpSouth MC 40	0.1%	67.8%
46	Desert Schools FCU	0.1%	67.9%
47	Suncoast Sch. FCU	0.1%	68.0%
48	SchoolsFirst FCU MC	0.1%	68.1%
49	The Golden 1 CU	0.1%	68.2%
50	The Bancorp Bank	0.0%	68.2%

PIN Debit Card Interchange

Sources: Nilson, #918, #919, #923
Federal Reserve Bank of Kansas City

Rank	Issuer	% Interchange Market	Running Share
1	Bank of America	13.4%	13.4%
2	Wells Fargo V	9.5%	22.9%
3	JPMorgan Chase V/MC	7.6%	30.5%
4	Regions Bank	1.4%	31.9%
5	PNC V	1.3%	33.2%
6	U.S. Bank	1.3%	34.5%
7	SunTrust V	1.2%	35.7%
8	TD Bank V	1.1%	36.9%
9	Citibank	1.1%	38.0%
10	BB&T V	0.9%	38.9%
11	USAA	0.8%	39.6%
12	Citizens Bank	0.7%	40.4%
13	ICBA Bancard V/MC	0.7%	41.1%
14	State Empl. CU, NC	0.5%	41.6%
15	Capital One V/MC	0.5%	42.0%
16	KeyBank MC	0.5%	42.5%
17	Compass Bank V	0.4%	42.9%
18	FIfth Third V/MC	0.4%	43.3%
19	Union Bank Calif.	0.4%	43.7%
20	Zions Bancorp. V	0.3%	44.0%
21	Bank of the West	0.3%	44.3%
22	Sovereign Bank V	0.2%	44.6%
23	Commerce Bank Mo.	0.2%	44.8%
24	BECU MC 37	0.2%	45.0%
25	First Horizon V	0.2%	45.2%
26	BancorpSouth MC 40	0.2%	45.3%
27	Desert Schools FCU	0.2%	45.5%
28	The Golden 1 CU	0.2%	45.7%
29	Arvest Bank V	0.2%	45.8%
30	Suncoast Sch. FCU	0.2%	46.0%
31	First Citizens N.C.	0.2%	46.2%
32	Comerica Bank V/MC	0.2%	46.3%
33	Huntington Nat'l	0.2%	46.5%
34	People's United	0.1%	46.6%
35	Harris N.A. MC	0.1%	46.8%
36	Associated Bank MC	0.1%	46.9%
37	SchoolsFirst FCU MC	0.1%	47.0%
38	M&I Bank V	0.1%	47.1%
39	Navy FCU	0.1%	47.3%
40	TCF Financial V	0.1%	47.4%
41	M&T Bank V/MC	0.1%	47.5%
42	Synovus V 39	0.1%	47.6%
43	HSBC MC 30	0.1%	47.7%
44	FirstMerit Bank V	0.0%	47.8%
45	Town North V/MC	0.0%	47.8%
46	BOK Financial V	0.0%	47.8%
47	FirstBank Colo. V	0.0%	47.8%
48	MetaBank V/MC/D	0.0%	47.8%
49	E*Trade Bank V	0.0%	47.8%
50	The Bancorp Bank	0.0%	47.8%

Exhibit 5

January 15, 2010

The Honorable Charles Schumer
The Honorable Kirsten Gillibrand
The Honorable Tim Bishop

To my Representatives in Congress:

I'm writing as a small business owner who has an opinion on almost everything. But, to avoid writing a book, the subject today is credit card fees being charged by the big banks to the small merchant. I know there's legislation pending on this issue. And I know there is a lot of negative consumer sentiment regarding banks. Perhaps my situation will help sway a few votes to the side of right.

In the past month there have been five occasions where banks have initiated charge backs against my account. Three of the incidents were because the cardholder claimed the card was stolen. The other two were initiated by the Bank of America because they *suspected* fraud... two transactions of identical amounts on the same day. (Not unusual in a bar when a customer orders the same round of drinks.) In all five transactions the money was deducted from my account before I had any communication from my card processor requesting verification of the charges. *The big banks took the money of the small merchant assuming guilt before innocence.*

Since I check my account on a daily basis, I notice the debits. I called to ask about the deductions and was told of the claims against me. In all cases, I immediately faxed the proof that all five transactions were approved by the banks and that I did nothing wrong. I have so far been credited for the first three; I'm waiting for the last two. They're very fast to take my funds, very slow to return them. I should also note that had I not called I would have to wait until I got the letters requesting my response. In three cases the letters arrived on December 24th requiring a response by December 23rd. Even I'm not that good that I can respond 24 hours ago to a request.

Now, you'd think it couldn't get any worse... but it does. I've lost the use of the money for a period of time. I've proved that I did nothing wrong and that all the charges were legitimate. I've been credited the money for three of the five transactions and am waiting for the last two. I am now charged $15.50 for each charge back as a fee. A total of $77.50 in fees for $78.00 in charges that I processed correctly and within the letter of agreement with the card processors!!! Mr. Schumer, Ms. Gillibrand, Mr. Bishop – this is ridiculous. I lose the use of my money for weeks, then I have to pay a fee of 100% to get it back.

I write to you today in the hopes that you can appreciate both my frustration with the situation and that you can see just how ludicrous it is. I am a small merchant who is trying to get by, trying to provide employment, trying to pay my bills. I feel that I'm being nickel and dimed and $77.50'd by companies that are trying to shore up their revenues before the new credit card legislation takes effect. I ask your help if you too see the inherent wrong in this situation.

Sincerely,

Marc Miller
Owner

111 West Broadway Port Jefferson, NY 11777 631.642.2824 info@thecatchtavern.com

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Mr. CONYERS. Thank you.

John Blum, we are all against class warfare, but it seems like this is big guys versus little guys. What free advice or counseling would you give the other men at the table here this morning?

Mr. BLUM. You know, in direct response to that, you know, big guy versus little guy, you know, as—even with that—the caveat, if you will, the exclusion for a credit union, I cannot imagine that any adjustment or payment or additional tier to a payment industry—

I mean, there is an interchange rate; there are interchange rate tables. I think if we have private agreements, modifications, if you will, to it, we yet have another table, then we have another table, and then we have another table.

I cannot imagine the payment card industry absorbing the compliance technology management costs for managing an even more complex set of rules and tables without passing it on to the end-user. So I don't think that I am excluded from the costs of this bill.

Mr. KANTOR. Mr. Chairman, if I could say one thing about this, it is not necessarily the case that anything in the legislation makes these fees more complex. In fact, merchants would very much like for it to be a simpler system. The Government Accountability Office, in their study that was published last year on this, found that this system over the last 15 years has become remarkably more complex and that the rates have become remarkably higher.

In 1995, 15 years ago, MasterCard, for example, had four different rates on their rate schedule. Today that number is 263. That makes it very difficult for merchants to know what they are paying when they pay and predict what their costs are going to be.

The GAO said, in fact, that of those rates a huge percentage of them—the new rates introduced are higher than what they were before. So we would like to simplify the system. We would like to be able to sit at the table and negotiate it and see what happens. Nothing in the bill dictates what the outcome of those discussions would be.

Mr. CARPENTER [continuing]. Simple points that, you know, as retailers, I mean, our net profit margin in our industry is 2 percent. The credit card industry is over 40—the two big players, Visa and MasterCard. So we are a very transparent industry, very competitive industry.

And I would also like to add that we are not in the financial institution business—financing business. We don't issue credit to people. This isn't our business. We are simply giving the card companies a venue for their customers to use their product.

We aren't in the business of financing customers and giving them credit, whether it be good or bad. We don't sit at the table and determine what kind of credit those customers get. All we do is give them a place to swipe their card so they can use it, because if they didn't have a place to swipe it they wouldn't have a business.

You know, so 15 years ago we were actually a larger company—my company, my family business. We took cash and checks. Cash was cash and checks were traded at par. Fifteen years later $900,000 to accept payment. It is unbelievable.

You know, one of my stores has fees of over $220,000 a year in fees. Drive by a gas station, three-quarters of an acre property, look at it, and think, "It is paying nearly $20,000 a month to accept credit cards at it." Our rent, the person who built that store and owns the land and rented it to us, was $138,000.

You know, we can afford to pay for the processing, which we do a significant portion of it—we pay for the satellite systems and all the machines to accept it. We can't pay for their business of financing customers, giving them credit, absorbing their fraud. That is not the business we created. We simply sell gas and convenience items.

Mr. CONYERS. Is it accurate that interchange fees have tripled over the last 10 years?

Mr. CARPENTER. Yes, in a couple ways. Interchange has gone up. They follow the prices; they are percentage-based, so they all know when gas prices go up it is—if gas is $1 interchange is two cents, if gas is $4 it is eight cents.

Our average margin on fuel for my company is 12 cents. So when gas 2 years ago was at $3.50 and $4 it ate up a significant portion of my—well, the majority of my margin.

The other reason it is going up is because we are now at 80 to 85 percent of our business is paid for with credit. I mean, to us it is just a currency. I mean, we used to take checks. If 15 years ago, when we were taking simply cash and checks, and you came to me and said, "We have a system where now your people can pay with credit, would you pay $900,000 for that service?" The question would be unequivocally, "No. We couldn't, can't, won't do it."

Mr. CONYERS. Steve King, this is the best witness you ever brought out of Iowa. [Laughter.]

If you have got any more we would be happy to schedule them in the future.

Mr. KING. We have about 3 million.

Mr. CONYERS. Then I probably won't be seeing you much more than—you call—if you have got that many that are like Carpenter.

Lamar Smith?

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Carpenter, just to follow up on that last answer, you say you pay $20,000 a month in interchange fees. That would translate into, would it not, over $1 million in business every month, of which—from which you are paying the $20,000? Is that correct?

Mr. CARPENTER. That would be correct.

Mr. SMITH. Okay. I just want to put it in perspective. $20,000 sounds like a lot, but if it is—but it is still only 2 percent of over $1 million in business——

Mr. CARPENTER. It would be less than $400,000 in margin. The number sounds like a lot on the sales, but from a revenue margin standpoint it is very small as——

Mr. SMITH. I understand that.

Mr. CARPENTER. Right.

Mr. SMITH. Mr. Blum, a question for you: What constraints now exist on credit card companies that would prevent them or discourage them from raising interchange fees?

Mr. BLUM. I can't testify for Visa or MasterCard as far as what constraints that they have out there. You know, quite simply, as I understand the interchange fee structure, you know, as a financial institution it is an offer to me as well to participate in the system and saying, "You know, if you participate in this system, if you accept these costs, if you accept this risk, then this is, if you will, the interchange fee that you could possibly earn. Now, you have to pay for all your risks, you have to pay for all your costs."

Interesting, I think someone testified that interchange fees have tripled in the last 3 years, or doubled—I am not quite sure what that number was. I can tell you that our net income has dropped, actually, while volume has increased. My fraud is exorbitant on it.

$800,000 in fees is a wonderful thing; I would like to have that limitation on the fraud on my portfolio.

I would also like to comment, I believe Mr. Carpenter, from the bank side, testified that interchange was not—there was not profit. Interchange provided not a penny of profit to his bank. That would reason me to believe that the best case is that it is a break even function and any reduction in it would actually cause a loss to the financial institution if interchange fee is providing no profit to him.

Mr. SMITH. Okay. Thank you, Mr. Blum. I think there may be some profit involved with some of the institutions, but appreciate your answer.

Mr. Kantor and Mr. Mierzwinski, I have the same question for you all, and that is, if this legislation were enacted, would the savings to the merchants be passed onto consumers? If so, how and why, and how would that be enforced?

Mr. KANTOR. I appreciate you asking the question——

Mr. SMITH. Sure.

Mr. KANTOR.—Congressman. Mr. Sensenbrenner was not kind about my views on this earlier. It would be fair for him to be not kind about me personally, but I actually think my views on this are well established.

We believe that the American competitive market system actually works, and here is how it works: It works in that there is an incentive for businesses, especially at the retail level—convenience stores, department stores, and others—to reduce their prices as much as they can to attract more customers. And so what they do is they make sure they can survive as a business—that means they have to cover their costs and have some rate of return—but otherwise they try to keep those profit margins narrow.

And I have included with my testimony a couple of exhibits that show across retail industries profit margins are very narrow and stable. They are from 1 to 3 percent, give or take. In some of these industries—convenience stores, grocery stores—they are very narrow.

Mr. SMITH. Are you basically saying there would sort of be a free market balance here—maybe some additional profits and some savings to the consumers both?

Mr. KANTOR. That is exactly right. Now, I don't know that there would be additional profits or not. The Department of Energy's 2003 study they did looking at gasoline markets and pricing, and what they determined, in fact, is that there is 100 percent passthrough of cost increases and of cost decreases in the—to the business—in the form of prices to the consumer. One hundred percent.

Now, gasoline markets are particularly competitive because people put their prices out on the street, but that is indicative of the type of competition that goes on today. In fact, I think most business owners today will tell you that these fees have gone up so dramatically over the last period of several years that right now they haven't been able to fully pass through the increases. They are passing through as much as they can but they are eating some of that—those increases.

And so if the market turned the other way might they recover some of the losses they are suffering now? Possible, but there is no doubt the majority of it would go through in consumer savings. And frankly, if folks don't believe that then they must believe there is a market failure and the competitive markets here don't work and we ought to get to that problem.

Mr. SMITH. Thank you, Mr. Kantor.

Mr. Mierzwinski, can you respond very quickly?

Mr. MIERZWINSKI. Certainly, Representative, and I would concur with Mr. Kantor's comments. I believe that the savings would be passed on. I believe the market would enforce that mechanism because I believe retail is much more competitive than people give it credit for. I would be happy to provide some independent comments on that for the record.

Mr. SMITH. Thank you all for your answers.

I yield back, Mr. Chairman.

Mr. CONYERS. Subcommittee Chairman Bob Scott?

Mr. SCOTT. Thank you. Thank you, Mr. Chairman.

Mr. Kantor, how much variation is there in price between MasterCard, Visa, American Express, and Discover?

Mr. KANTOR. Visa and MasterCard are very, very close. I couldn't tell you the exact figures, but we could provide that to you later. American Express is a little bit higher and Discover Card is a little bit lower.

One of the problems here—that rule I pointed to earlier causes this real problem: We know that some of the smaller players, like a Discover Card, are quite eager, some might say desperate, for more market share here. They have been for a long time.

One of the bases, usually, that a company would use to gain more market share is they would cut their prices and try to gain more market share that way. But Discover Card cannot do that here because if they cut this fee the consumer doesn't see that and can't make choices based on it because merchants are prohibited by Visa and MasterCard from giving the discount for use of the Discover Card. And so that fee remains very close, although a little less, but very close to what Visa and MasterCard's fee is, and there is no incentive for them to drop that fee further and——

Mr. SCOTT. Some merchants accept Visa and MasterCard but not American Express or Discover. If they have a lower fee, would not the merchant be more likely to accept Discover and/or American Express?

Mr. KANTOR. As I said, American Express' is a little bit higher, so yes, some merchants don't take them. The primary reason is they don't have the power in the marketplace Visa and MasterCard do. Visa and MasterCard combined are more than 80 percent of this market, and what merchants respond to is what their customers want, and that is what they take.

Mr. SCOTT. If the price of MasterCard and Visa are so close why would that not be antitrust violation?

Mr. KANTOR. Well, I think you would have to—to find that itself to be an antitrust violation I think you would have to find some degree of collusion or the concept of conscious parallelism, something like that between Visa and MasterCard. We don't know whether that is the case or not and haven't made that contention. Our problem here is that under the umbrella of Visa and MasterCard all of these banks who are, indeed, competitors agree to charge that default schedule of rates and the same rates, and that is a problem where the banks aren't competing.

Mr. SCOTT. Well, you have a provision that you have to—you cannot give a discount for various—for using somebody else's card. Why would that not be a restraint of trade?

Mr. KANTOR. We believe it is.

Mr. SCOTT. Has it been litigated?

Mr. KANTOR. It is currently the subject of litigation in the eastern district of New York.

Mr. SCOTT. And that would include cash discounts?

Mr. KANTOR. Cash discount is slightly different in that the Federal law, Truth in Lending Act, tells Visa and MasterCard they cannot prohibit a cash discount. The credit card companies do, however, make it very difficult and create a number of hurdles for merchants to be able to discount for cash.

I have included with my testimony a story from the publication Oil Express where one of these—there are many of these conflicts—but one of these blew up and made its way into the press where Visa was threatening to fine one store operator $5,000 per day for offering a cash discount, and in fact was pressuring him to advertise his prices in a way that violated California state law, and that is in the testimony. It is a problem, but it is a little bit different because they don't simply have a blanket prohibition on the cash discounts.

Mr. SCOTT. Mr. Blum, what portion of the interchange fees go to frequent flyer rewards and other kinds of incentives that some credit cardholders get and many don't?

Mr. BLUM. You know, there is a portion of it, Mr. Scott, that goes to it. I don't know the exact number. Within the credit union I have been on the debit card portfolio; I do not offer a rewards program.

On most of the credit card programs they are also reward-free. I do have one credit card bin that has a cash-back program of 1 percent that members have asked for, and I have given it. And I will be truthful with you: On that 1 percent cash-back portfolio the credit union is upside down. It costs me more to have that portfolio than it has to have any of my other portfolios.

Mr. SCOTT. Well, is there some industry average of how much of interchange fees go to the reward programs?

Mr. BLUM. You know, not to my recollection. I can find that answer out for you, though, and submit it to you.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. CONYERS. Bob Goodlatte, Chair of the—former Chair, vice—Ranking Member of the Agriculture Committee is recognized.

Howard Coble?

Mr. COBLE. Thank the gentleman from Virginia, Mr. Chairman, Jim Schiff, but I will be glad to respond.

Good to have you all with us, gentlemen.

Mr. Kantor, I am going to put a two-part question to you: How has the Merchants Payments Coalition come to the determination that interchange fees are too high, A? And B, can comparisons be made to the interchange rates that are charged in other developed countries?

Mr. KANTOR. Thank you for the question, Congressman. It is an interesting one, and I think these two questions are tied together.

I have provided in my testimony a chart showing interchange rates in countries around the world. The United States and American consumers are paying the highest rates in the developed world right now of about 2 percent.

If you take a look, for example, in Europe, the cross-border rate that MasterCard, for example, has agreed to on credit is 0.3 percent as opposed to the 2 percent we pay here. Australia, they did a study of this and regulated their fee at what they thought was reasonable; it is half of 1 percent, as opposed to the 2 percent here.

But if you look at the list it is very interesting. There are countries around the world, including developing nations, that pay less than us and have not regulated this marketplace in any way.

Why is that? The reason for that, as far as we can see, is this combination both of the market power that Visa and MasterCard have developed in the United States and the anticompetitive practices that we have described.

And so we see that they are vastly inflated. One banking consultant, for example, said that only 13 percent of the interchange is the cost of processing.

I have also put in my testimony information from Cards and Payments. That publication says that 60 percent of the interchange is profits.

Now, that is a remarkable figure, given what Mr. Carpenter's testimony and what I have put in about retail profit margins. Retail profit margins are 1 to 3 percent, and so for 60 percent of this to be profit, that strikes us as anticompetitive, overinflated, and much too high.

And Mr. Blum's point is actually right, I agree with him. It is a very good one. For small institutions—credit unions, community banks—that is not the case. They don't have the economies of scale to spread these costs out over a larger cardholder base. They are not making big money, as far as we can see, on this.

But the largest institutions—10 banks—make 80 percent of the interchange. Those 10 banks are making huge profits and are guaranteed huge profits because they don't have the price competition from other competitors, large or small.

Mr. COBLE. Thank you, sir.

Mr. Blum, let me ask you a simple question. It may induce a complicated answer. Why are interchange fees important to your credit union?

Mr. BLUM. The interchange fees provide us an opportunity actually to play these card programs. The consumer, our members, want the card payment system. They want it. They are tired of standing in line trying to process a check or walking into a place that doesn't accept checks, or, you know, going into a small retailer—maybe even a large chain I can think of—paying with a $20 bill and then waiting 45 seconds for the little vault to open so that they can get the little three tightly rolled $5 bills back.

Obviously it is a lot faster for them, it is more efficient for them to have this. And in order for me to have that program I have got to be able to generate, if you will, some revenue to pay for it.

So that interchange fee pays for the card, it pays for that phone center staff that receives the call in the middle of the night when the consumer looks at the statement and sees that there is a

$10,000 charge to Best Buy and they didn't make it. They are not calling Best Buy to get their money back; they are calling me.

I have to staff that, I have to process that $10,000, I have to write that $10,000 down and absorb it, I have got to reissue a card. I usually have to send it out overnight mail for that consumer along with new checking products, new checking account, new numbers in order to protect that member from further fraud losses.

So that interchange fee, sir, is just a component of what I use to be able to pay for that system that the consumers ask for.

Mr. COBLE. I thank you.

I want to beat that red light, Mr. Carpenter. Mr. Carpenter, how much of the interchange is passed on to consumers at your stores?

Mr. CARPENTER. It depends by market—that is a tough question. In my market, so I only can speak for myself, the majority of it gets passed on at certain times; certain times it doesn't. Markets are very competitive. We have huge competition. You know, three chains in my market—one has 1,500 stores; one has 550; one has 450—they market all over the country. I have six.

So, you know, we compete in markets where, you know, we don't want to all compete on the same level. So sometimes it does, sometimes it doesn't. It depends on the time and the complexity of the market you operate in.

Mr. COBLE. I thank you, sir.

Mr. Chairman, I see my red light has illuminated so I will yield back.

Mr. CONYERS. Mel Watt, North Carolina, senior Member?

Mr. WATT. Thank you, Mr. Chairman. I am not as senior as my Republican counterpart who just asked questions, either in age or in longevity of service, but I will take the compliment.

I kind of hate to sound like my friend, Mr. Sensenbrenner, but I haven't quite been convinced of the value of the bill either, Mr. Chairman. I would have to say I have either the benefit or the burden of serving on both Judiciary Committee and the Financial Services Committee, and was a supporter of Ms. Maloney's bill to regulate the credit card industry because it identified specific practices that we thought were unacceptable in the marketplace and outlawed them. And I think to the extent we can identify unacceptable practices in the interchange fee space we should outlaw those unacceptable practices, some of which Mr. Kantor has referred to.

If we think it is unacceptable for there to be a prohibition against cash discounts we ought to say that it is unacceptable for that to be a prohibition. If we think it is unacceptable to—for there to be a prohibition against discount for lower-cost cards we ought to say that and outlaw that.

But I kind of live by the proposition that I learned from my mother a long, long time ago that two wrongs don't make a right, and to grant one part of an industry an exemption from antitrust laws just seems to me to not be an appropriate way to deal with somebody who appears or may be violating the antitrust laws on the other side. It just doesn't seem to me to be an appropriate way to proceed.

So having said that, I keep coming to the hearings to learn more about what the new version of this bill will be. I don't think granting an exemption to a group of retailers is the answer here, and

I don't see how we can enforce the passage of that end savings that would result, if you assume that there are savings, along to consumers, and I think there may be some ways that we could do that if we just said it is illegal to enter into a contract that says you can't advertise and accept a lower-cost card or have a discount—have a cash discount, which apparently is already illegal.

I like Mr. Mierzwinski's—I may be messing up his name—testimony about the consumer financial protection agency. I have been one of the strong proponents of that in the Financial Services Committee. And that agency might well have the capacity to identify some of those unacceptable practices, and I hope we will get a robust consumer financial protection agency in the Senate bill when it comes out so that we can have that.

I like his suggestion about private rights of action because I think if enough consumers litigated about some of these issues that, in and of itself, would be a cost-effective approach—or it would be so burdensome on the system that a lot of these practices would terminate, although I am sure some of my Republican colleagues would object to any kind of litigation or private rights of action.

So I think there are ways we can get at this, I am just not sure that the approach that we are using in the Chairman's mark is the appropriate approach.

Mr. Carpenter, I guess I ought to ask one question since I have given my opening statement. Any of your stores still accepting checks?

Mr. CARPENTER. Yes, we do.

Mr. WATT. What is the default rate on—or failure to pay rate on a check?

Mr. CARPENTER. We pay five cents to process a check.

Mr. WATT. And sometimes they bounce?

Mr. CARPENTER. Very rarely today. We have ways to scan that check. But historically, back when we took checks, you know, many checks versus credit cards, that fee on a comparable amount of business, we may take in $30,000 or $40,000 a year in bad checks.

Mr. WATT. So you are saying that fee would have been substantially less than you are paying in interchange fees?

Mr. CARPENTER. You know, Mr. Kantor is much better at knowing the specifics, but I can tell you that—the debit card, which is like cash—it is an electronic form of cash, which should be cheaper because you are not sending checks to customers, you are not writing them, the banks not sending them back to the customer—the electronic version should be cheaper and it costs anywhere from eight to 15 times more for us to take electronic debit versus a check, depending on the price of——

Mr. WATT. I am not sure you have answered my question. I am trying to figure out the loss ratio for checks.

Mr. Kantor, you know the answer to my question?

Mr. KANTOR. I am afraid I don't know the figure. Usually, though, what merchants do is they pass through to the consumer where there are those lost check fees, and so for merchants the check problem, where checks are——

Mr. WATT. Nobody is sitting under the illusion that interchange fee costs are not being passed through to consumers. I mean, we all understand that.

Mr. KANTOR. But that gets passed through—the difference, Congressman, is—to every single consumer in the prices that you pay. It is a very different thing to say to one consumer, "You bounced a check. Hey, there is a fee we have when you bounce that check," than to have to raise all of your prices across your store, and that creates an impact in the market—as I said, fewer sales. Lots of people won't come in the store, won't buy something as a result.

Mr. WATT. I understand that intellectually and academically, but as a practical matter I think the cost of a bounced check was being passed along to customers who paid in cash also.

Mr. CARPENTER. I think I can—you know, we typically—back when I said we take in, you know, approximately $40,000 in bad checks, we usually paid for that loss in the form of bad check of expense back to that consumer. So it was a neutral event for us to take checks.

Mr. WATT. All right.

Mr. Chairman, I didn't mean to be negative on your bill, I just—I am just negative on your bill. [Laughter.]

I didn't mean to be. But I just am not convinced that giving an antitrust exemption doesn't double the wrong here as opposed to correcting the wrong, I guess is the problem I am having.

I yield back.

Mr. CONYERS. Randy Forbes, Virginia?

Mr. FORBES. Thank you, Mr. Chairman.

Gentlemen, thank you all. You are all good men. You are doing a good job and you are trying to fight for your businesses. A lot of good men and women are behind you, all of whom would like to be at this table giving their input. Unfortunately, they are not there.

And I understand that there are good points on both sides. Sometimes a talking point can kind of stretch your imagination just a little bit. I start with the premise that credit cards, I think, have destroyed some people's lives. The marketing we do is terrible, but that is not the issue that we have here today.

And, Mr. Carpenter, when I heard you suggest that you guys were having stores so that the credit card companies could use their product that is kind of like the builder saying he is building homes so the mortgage company can exercise and sell its products. I mean, the reality is that when you talk about the size of the payments you are making and the reality of the situation a lot of your customers couldn't buy your products if they didn't have the credit card capability to use. And sometime when you suggest the fees that you are paying that just shows how valuable those credit cards actually are.

But here are my two questions: Mr. Blum, first of all, for you, you talked about the difficulty of keeping up with differences if you had the different interchange fees. You guys are masters of software programs. I can be halfway across the globe and you can tell me how much I have got in my account exactly. You can tell us if we are a day late on a payment, and you can increase our fees on that.

I would like for you to tell me what is wrong with just having the ability to negotiate these fees—and I am not talking about a court enforcement, you know, if it doesn't happen, but why shouldn't they have just the ability to sit down with you and negotiate these fees? And I am not totally sold on the fact you guys couldn't create the software to manage it.

But before you do it, Mr. Carpenter, I want you to be thinking about this question for you: If Microsoft were to come up with an incredible program that all of your stores and stores across the country had to have for inventory control and you said, you know, "We have just got to have this program because it is the best program in the country," what would give you the right to come in and say to them that they needed to reduce the licensing fees that they had for you? How is that any different than the credit card——

So, Mr. Blum, if you would go first, then, Mr. Carpenter, we will come back to you.

Mr. BLUM. Thank you. You know, most of all—you know, overall, if you are asking me how can I figure out how to have everybody come to me, if you will, directly negotiating and create a software system that can run it, there is one out there. I couldn't afford it if I had to build it today—the current payment system that spans globally. I think it might be just a little bit more complex than we are letting it be.

You know, and I commented that there are tiered rates on the interchange, and those rates have to do with volume. They also have to do with fraud losses from that merchant category and from—and times from that merchant.

Back up that the merchant can negotiate—they can't negotiate the interchange fee, which is, if you will, mine, okay? They can negotiate with their processing bank, you know, the overall, the total package, the discount fee, what their bank is paying, to simply pass all the risks, the liabilities, and the financial, you know, requirements on to me. So that component, if you will, is negotiable.

But I will point out that I do happen—Chartway does happen to have a business partner where we have a branded rewards card, if you will, specifically for that business that tracks the members' spend in that business and returns rewards to that member that they must use in that business. The complete interchange received on that—on all those transactions in those businesses is, in fact, returned to the consumer in a form that they must—a store gift card, if you will, for that store; they can only use it back in that store.

So merchants have the ability to come to institutions and create, if you will, specific rewards programs. In fact, I believe that there are a number of merchants that are in the rewards program business, where they offer the rewards—Home Depot, you know, gift card as a reward; the airline miles as a reward. If you, you know——

Mr. FORBES. Mr. Blum, I don't want to cut you off but my time is just about up. Can I just get to Mr. Carpenter—and I would love to listen to more of that response, and not trying to cut you off. I only have 5 minutes.

Mr. Carpenter?

Mr. CARPENTER. Thank you. First of all, with six stores I am no Home Depot, so we certainly don't have the ability to create our own card and our own card network.

You know, we look at everything, as any business should, from a financial point of view. And I want to be very clear: The processing of credit cards, the use of plastic, I think is a good thing. The system works well.

Did we have any idea 15, 20 years ago, when it first was introduced to us and most transactions were passed close to par—it was 5 or 10 percent of our business within a few years—did we have any idea that two of the players would control 80 percent of the business, 85 percent of our customers would be paying using that card, and it would cost us an enormous amount of money that we have, you know—he says we don't have the ability to negotiate interchange. Well, that is 90 percent of the cost of this cost to us——

Mr. FORBES. My time is up. Can you just address the Microsoft example? Why would that be any different if it was a software program that you just had to have? You didn't think when you began to use it you were going to use it that much, but now you are using it so much you are dependent upon it——

Mr. CARPENTER. If Microsoft came to me today with some technology to help us sell gas and it was going to take 50 to 60 percent of our margin to do it——

Mr. FORBES. That is not what I am asking. I am saying, if Microsoft came to you with an inventory program and you became so dependent on it because it was such a good program, and all of a sudden you looked and you were using it so much your licensing fees were a huge amount of money, what would give you the right—you could walk away from it—but what would give you the right to say to Microsoft, "No, no. You can't charge that. You have got to——"

Mr. CARPENTER. If it became that prevalent in our industry, where 80 or 85 percent of my competition had it as well, I would hope that we also became strong enough to have a voice to go to Microsoft and negotiate that fee down. And at some point Microsoft may have a competitor who could then compete with Microsoft, who would then lower that price.

Mr. FORBES. Mr. Chairman, thank you for your patience.

Mr. CARPENTER. So that is how it works. It is not working that way in this case, by the way.

Mr. CONYERS. Dan Maffei, New York?

Mr. MAFFEI. Thank you, Mr. Chairman.

I just want to ask a couple of quick questions. One is—I am still confused about the risk discussion, because it seems that, to me, both sides are the last holders of the risk.

So I guess I will ask Mr. Carpenter, Mr. Blum, and then if those answers are incomplete, we will ask others, who—if somebody comes in and has a card, and it is a a fraudulent card, and purchases something in your store—do you still get the money? Or do you have to—what kind of risk is that to you? Obviously, you don't know it is happening at the time.

What—what do you see as a loss later on?

Mr. CARPENTER. If it is a fraudulent card, as long as we have followed the process, either, you know, acquired a PIN or a signature, we typically would not get charged back for that. I can tell you from our bank's standpoint, a quarter of a percent of our transactions are fraud. And the reason for that, our bank has a higher level of credit score and credit rating that you must pass to obtain credit. And so we have some control over, you know—that would be more in the form of charge backs, but yes.

Mr. MAFFEI. Okay.

Mr. Blum, is it your credit union that would take the loss?

Mr. BLUM. Yes, sir.

Mr. MAFFEI. And how does that work? You just eat it? I mean, what——

Mr. BLUM. You know, basically I have to eat it. I mean, I have to follow the same rules. If it was a properly authorized transaction, regardless of whether or not it was a fraudulent card, I end up eating it. The consumer, you know, makes a statement that they did not make that charge. I then follow the rules and give them credit.

You know, interesting, just a couple of weeks ago we received a couple of captured cards out there—these are fraudulent card numbers that we have identified as fraud and we have put a capture code on them. They were returned to me.

All four of them were white plastic with absolutely no writing on them; all it had was a magnetic stripe. I mean, there wasn't even an attempt to disguise that it was just a piece of plastic somebody had created—fraudulent activity. Yet, not only did I pay the capture fee for those cards, I paid for the fraud on those cards, I paid to restore the members' accounts, I paid for the new cards that are being processed—that had to be developed, I had to pay for the statements that had to be sent out, if you will, or the PINs, the notices, my staff that handles just the fraud.

And I pay a significant amount of money to a very robust anti-fraud engine where I pay for half of the fraud they stop because it is less expensive to me than to pay for the fraud.

Mr. MAFFEI. I will come back to you, Mr. Kantor.

Mr. Mierzwinski?

Mr. MIERZWINSKI. Yes. Congressman, there is a third party here, and that is the consumer. And the consumer, in fact, is increasingly paying for the cost of fraud because banks are not honoring the laws that require them to do reinvestigations and pay consumers when they are victims of fraud. Credit cards, in——

Mr. MAFFEI. Stop there. I don't quite understand. Are you saying that Mr. Blum is not accurate?

Mr. MIERZWINSKI. No, no, no, no. I am saying it is a three-sided dispute. The merchants sometimes pay if they don't follow the rules; the banks pay if the merchants follow the rules; but the banks also argue to consumers that we didn't follow the rules and that we should pay sometimes.

Mr. MAFFEI. How do you mean we didn't follow the rules?

Mr. MIERZWINSKI. I know we don't have time for a long, detailed discussion, but the Truth in Lending Act limits consumer liability to $50 on a credit card. The debit card law is different. It was originally written for PIN-based transactions. But because the banks wanted to make so much money on interchange, they wanted to use the credit card network, they began to allow the cards to be used on signature transactions.

So there is much more fraud. Banks are saying that consumers are subject to a higher liability, even though the law says—I am sorry, their contract says zero liability, but the law provides for even up to all the money in your account can be lost by the consumer in certain circumstances.

That is why consumers believe that the Electronic Fund Transfer Act needs to be amended, so the consumers have the same protections in all transactions.

Mr. MAFFEI. Well, we will look at that at another hearing, but thank you for your comment.

Mr. Kantor, I will let you have the rest of my time, but I want to add a follow-up question. Or actually a somewhat different question, which is—I think you mentioned it earlier—or somebody mentioned earlier—that there was a case going on in the Eastern District of New York where the merchants were trying to get Visa and MasterCard to—basically suing Visa and MasterCard for not allowing competition.

Why shouldn't we just wait to see where the case goes? I mean, if the current laws already are sufficient, if that case is decided, should—should we not wait for the end of that case?

Mr. KANTOR. Thank you, Congressman, for—for both questions. On the fraud question, I think, it is important here—I included with my testimony a letter from the owner of The Catch Seafood Tavern in your state, Port Jefferson, New York. And they described a situation that is all too common, which is he, in a given month, had five of these so-called charge-backs from his credit card provider. The charge-back is where the bank refuses to pay the merchant the money for the transaction—but that is what they call it, the charge-back.

These were all because of—supposedly fraud had gone on in the transaction. He went back to the bank, over time, and—and gave them information about why he thought he had done everything right, why he thought they were, in fact, good legitimate transactions. All described in his letter. And finally, after weeks of haggling with the bank, they agreed—"You are right"—all the transactions were right, there was no fraud here. He got his $78 back.

And the bank said, "But to resolve each of these disputes, there is a fee, $15.50 for each of these disputes." There is a fee, of course, of $15.50, for each of the five disputes. So they charged him $77.50 in order to determine that he could get his $78 back.

Now, that is not a payment guarantee, and it happens over and over again. There are dozens of pages of rules Visa and MasterCard both have about when they can charge back the merchant.

And many banks—typically not the smaller institutions like Mr. Blum's—but many banks are quite aggressive about them. LexisNexis and Javelin Strategy did a study last year. And they determined that merchants absorb almost ten times the amount of fraud that the banks absorb. That is a staggering figure.

Mr. MAFFEI. All right, I am—I am out of time. We will look at that document.

And I agree with Mr. Watt that I think—part of the work that we are doing in Financial Services is probably more akin to that.

Do you have a quick two-sentence answer to my question? Why we don't just wait for the case and see what happens?

Mr. KANTOR. I do. These cases take an incredibly long time to play out. And there are some things the courts are good at and some things they are not as good at, and where Congress ought to assert it's own perogatives.

The Court is very good at figuring out, "Is this a violation of law?" and assigning some monetary value to the losses that may have occurred, if there is a violation of law. But the terms of figuring out what this structure ought to look like going forward, whether there are regulatory changes that ought to happen, or how the system ought to work so that it is fair, we think Congress is in a much better position to do that, as they were in the telecom——

[Crosstalk.]

Mr. MAFFEI. Thank you very much. I thank the Chair and the Committee for its indulgence.

Mr. CONYERS. Steve King?

Mr. KING. Thank you, Mr. Chairman. I should clarify my response earlier. We do have 3 million excellent witnesses in Iowa; we don't have another one like Dave Carpenter, however.

And while we are talking about states and loyalty, too, I regret Mr. Sensenbrenner wasn't able to stick around because it occurs to me that the fees on credit cards at $48 million, that is seven times the value of all of the beer that is brewed in Wisconsin. They should think about that as well. It is a large number.

But this, for me, comes down to—and a little bit different way of asking questions. I don't think I have heard this approach at all in this testimony, but we have contracts that one apparently can't divulge publicly, or at least can't reflect the costs of doing business in the retail, can't offer a discount that reflects or is comparable to the cost of doing business with particular credit cards.

I am a guy who has done a lot of markup and taken my hit in—I bid a lot of projects in the construction business and I have my itemization and my spreadsheet, and I put my margin in there, and I reflect my costs in everything that I do. And it is an easy equation once they come out with spreadsheets.

So it would occur to me that when Mr. Forbes asked a question about what if Microsoft comes up with a software plan that would be so good at doing your inventory tracking that it would essentially dominate the market, and you would have to have that plan working for you in order to be in business in the retail price, financial world, I just ask this question: Clearly, if one had information on all of this testimony that is here, it would be possible to draft a software plan that would reflect exactly the costs of doing business with each of the credit cards in regard to each of the pieces of inventory.

It may cost a lot more to put a pack of gum on a piece of plastic for credit than it does, say, $100 purchase worth of other items off the shelf, but I would think that could all be tracked by inventory item by cost, and I would think that you could tell me the cost of doing business for an individual inventory item, whether it would be paid for by cash, check, debit, or credit card, for a pack of gum versus a gallon of gas versus $100 worth of groceries, for example.

If someone produced that software package would anybody in the retail business—and I will go first to Mr. Carpenter—be interested in taking that up and having that software package reflect the cost of doing business and have it be a plus-up, depending on whether it would be cash, credit, debit, or check?

Mr. CARPENTER. Just to be clear, you are suggesting that we would have some program that would charge the customer based on how they pay for those various—if they had a higher rewards card they would pay a higher price for that pack of gum?

Mr. KING. Exactly. A plus-up or a discount, depending on which way you wanted to present it as a retailer.

Mr. CARPENTER. We have 4,000 items in our store. I mean, I can't fathom how that would—you know, our consumers think their credit card is like cash. And we talk about a discount—even if we did give a discount, the customer doesn't understand where that money goes.

If we said, "It is 10 cents more for this," they would think that was just a windfall profit for the retailer. They have no ability to determine that that is going to interchange, to a bank; they don't understand that, so to get a customer to explain—understand that a pack of gum has four different prices, I think, would be just—I don't know how you would even advertise a price on your, you know——

Mr. KING. I get your general response to this. Could you also do a calculation on a range of prices? For example, if your transaction is under $5 then reflect the cost of cash or credit in proportion to the size of the transaction? And then could you also separate that according to Visa, MasterCard, and the other cards?

Mr. CARPENTER. I suppose anything is, you know, possible from a technology standpoint.

Mr. KING. Because what I am getting at is—now, this testimony that I am hearing today is that you can't actually reflect the cost of doing business in your price because you might be fined if you offer that kind of a discount by the credit card companies. I am also hearing "threaten to fine," but I am not hearing testimony of actual fines.

I think maybe I should turn that over to Mr. Kantor, as my clock ticks down, and see if he can answer that question. Is anybody fined, or are they threatened to be fined?

Mr. KANTOR. There is both, Congressman. These do occur quite often.

I will tell you, though, that in most instances the threat of the fine is plenty. Take the instance where I included the article in my testimony of the single-store operator in California. He was threatened with a fine of $5,000 per day that he was out of compliance with this rule and discounting for cash——

Mr. KING. But I am interested——

Mr. KANTOR. The average per store profit——

Mr. KING [continuing]. Actual fines.

Mr. KANTOR. But understand, the average per store profits in the industry are $35,000 for the entire year——

Mr. KING. I do understand that.

Mr. KANTOR [continuing]. So most people—you know, this individual actually, he called me and said, "I am taping over my sign. Even if the state comes after me I don't care. I can't risk that fine." So there are both——

Mr. KING. I am just going to ask you, in the aftermath of this hearing, if you could present some documentation of actual fines, just for my personal use here, because I would like to know about the actual as opposed to the threatened.

But I don't bring this up to diminish your argument; I bring this up because I am thinking in terms of, if there are negotiations and you are able to sit at the table, will part of those negotiations be allowing the retailers to reflect the cost of doing business in their pricing by either a plus-up or a discount, and would you support that, Mr. Kantor?

Mr. KANTOR. Absolutely. The legislation, as it stands, allows negotiation over the price and the terms and rules around which the system works——

Mr. KING. And the transparency.

Mr. KANTOR [continuing]. And the transparency. And we are very interested in engaging on those issues.

Mr. KING. And, Mr. Carpenter, is that mostly your goal, too, is to be able to reflect those costs of doing business——

Mr. CARPENTER. We simply want to be able to sit down at the table and negotiate like we do with all of our vendors. We want to be transparent. That is all we are asking—the ability to negotiate this fee. That is it.

Mr. KING. I am going to accept that as a conclusion for my questioning, and I thank all the witnesses here today and the Chairman for calling this hearing. Appreciate it, and I yield back.

Mr. CONYERS. Debbie Wasserman Schultz?

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman.

Mr. Chairman, at the outset I want to say that I supported the Credit Cardholder's Bill of Rights and was a cosponsor of it because it, I felt, addressed the abusive practices of the banking—bank issuing credit card companies as well as the credit card industry.

But throughout the discussion over the last 2 years in this debate over interchange fees it continues to be hard to wrap my mind around several things: One is, in this version of the bill, why, in this economy, we are talking about giving an antitrust exemption to anyone, banks or merchants; two, that this legislation still does not ensure consumers that the savings that would perhaps be realized by merchants in these negotiations in this legislation would actually be passed on to them. We attempted to put that language in this legislation last year and it doesn't appear to have successfully remained in the bill in the presentation of the bill this time.

My question, Mr. Chairman, and I would like to address Mr. Carpenter to start off with, you are the owner of a retail establishment, correct?

Mr. CARPENTER. Correct.

Ms. WASSERMAN SCHULTZ. And you are here testifying on behalf of the National Association of Convenience Stores?

Mr. CARPENTER. Correct.

Ms. WASSERMAN SCHULTZ. Are you also testifying on behalf of the retail stores that you own?

Mr. CARPENTER. Correct.

Ms. WASSERMAN SCHULTZ. Okay. To quote you a few minutes ago, you said that you are not in the financial institution business. You also said that you are not in the business of deciding credit, except that you are. Are you also the director of a bank?

Mr. CARPENTER. Yes.

Ms. WASSERMAN SCHULTZ. Okay. What is the bank's name?

Mr. CARPENTER. Liberty Bank of Iowa.

Ms. WASSERMAN SCHULTZ. And your bank issues Visa cards?

Mr. CARPENTER. Yes.

Ms. WASSERMAN SCHULTZ. Are you testifying on behalf of the bank today?

Mr. CARPENTER. No.

Ms. WASSERMAN SCHULTZ. Are you testifying on behalf of a bank trading association?

Mr. CARPENTER. No.

Ms. WASSERMAN SCHULTZ. Are you testifying on behalf of anyone in the financial services area?

Mr. CARPENTER. No.

Ms. WASSERMAN SCHULTZ. So when you state your opinions regarding the impact of interchange on Liberty Bank or community banks you are not stating the position of Liberty Bank or community banks, correct?

Mr. CARPENTER. I am giving you the information from our bank only.

Ms. WASSERMAN SCHULTZ. So Liberty Bank disagrees with all the credit—and the industries testifying here today—the banking industry, the——

Mr. CARPENTER. What I am here to tell you, that credit card interchange and the card business to our bank, which is on the larger end of community banks, is not material to the revenue and/or profit of our business. The argument has been made that this is a material effect to the business of community banks.

Ms. WASSERMAN SCHULTZ. Does Liberty Bank disagree with those trade associations testifying here today on the position of interchange fees—Liberty Bank as a banking institution?

Mr. CARPENTER. I am not here as a representative of our bank to tell you whether we——

Ms. WASSERMAN SCHULTZ. Okay. I would imagine that is because they don't. Can you please——

Mr. CARPENTER. I can't answer that, and neither can you.

Ms. WASSERMAN SCHULTZ. Okay. Can you please describe whether you have any conflict of interest today when you indicate that Liberty Bank or community banks in general won't be harmed by the interchange legislation that is before us?

Mr. CARPENTER. I am not here to say either of those things, other than it is not a material portion of our business when it is made——

Ms. WASSERMAN SCHULTZ. You are sort of on both sides of the issue here, so that is my concern, is——

Mr. CARPENTER. Say that again?

Ms. WASSERMAN SCHULTZ. You are sort of on both sides of the issue here. You own a number of convenience stores while you are also the director of a bank——

Mr. CARPENTER. True.

Ms. WASSERMAN SCHULTZ [continuing]. That issues credit cards. We hear from a variety of small banks and credit unions and every single one of their trade associations that interchange legislation will hurt them, and Congress hears from one single bank director who owns retail outlets that interchange won't hurt community banks and credit unions. Who are we supposed to believe?

Mr. CARPENTER. Well, I would add that I didn't know what our bank made in interchange and how it would—if it had a material effect to our bank until 3 weeks ago when I sat down with the head of our credit card department. Our information at our bank was absolutely identical to the bank information that they had produced that at banks of less than $1 billion interchange makes up to zero percent of their profit.

Ms. WASSERMAN SCHULTZ. Okay. I might also point out that your bank is owned by a chain of 400 convenience stores, so the conflicts here are really just popping out from every corner.

Mr. Chairman, I want to conclude my questioning with Mr. Mierzwinski, who I have a tremendous amount of respect for and whose organization I have worked with for a very long time.

But, Mr. Mierzwinski, can you help me understand, for consumers shopping in stores how would an antitrust exemption for the banking industry and for merchants help them?

Mr. MIERZWINSKI. Well, very simply, Congresswoman, the goal here is to force the banks to negotiate with the merchants to make these prices transfer——

Ms. WASSERMAN SCHULTZ. But why isn't U.S. PIRG insisting that this legislation include a passing on of those savings to consumers? That is counter to every experience I have ever had with U.S. PIRG in an 18 year career.

Mr. MIERZWINSKI. If there were an amendment on the floor to do that we would consider supporting it. We would have to look at how it would work.

The problem here is that we are trying to move this along—that is one thing—but the second thing is, I really do believe that the market doesn't require Congress to order that kind of a result because I think that result happens anyway. I believe that this is a place, the retail industry, where the market works; I believe that interchange is a place where the market doesn't work, so that is the reason that it is not necessary that——

Ms. WASSERMAN SCHULTZ. Honestly, Mr. Chairman, the bottom line—and I have tremendous respect for you; I know this is your legislation and this is perhaps my last meeting as a Member of the Judiciary Committee, and I have really enjoyed my service on the Committee—but I would urge the Committee, as you move forward, to please, if this bill does get marked up at some point, to incorporate a passage of savings to the consumer in the event that we create this transparency that the bill would call for, because that is the overall drive—it should be overall driving concern: How does the consumer benefit? Not the merchants, not the banks, but the consumer.

Thank you. I yield back the balance of my time.

Mr. CONYERS. Well, if you stay on the Committee we will put it in. [Laughter.]

Ms. WASSERMAN SCHULTZ. I think that could be negotiated, but it is a couple stages above my pay grade. Thank you.

Mr. CONYERS. Judge Poe?

Mr. POE. Thank you, Mr. Chairman.

I want to thank my friend from Iowa for putting this in perspective with Wisconsin beer. I think during my 5 minutes if you would calculate how much the savings would be, or how much it would cost in perspective to Texas barbeque, and then I can relate to how much we are talking about.

Anyway, I got two—I want to talk to two of you on a couple of issues, Mr. Carpenter and Mr. Blum. I am a big fan of convenience stores. Their margin of profit is very small. Back in the days when I was a judge and convenience stores dealt mainly in cash we called those places "stop-and-robs" in Houston because they had a lot of money. Now they don't have a lot of cash, and security is better, and robberies are down, which is good.

But let's talk about cash, and checks, and credit cards. What is the margin when you are using cash and checks versus credit cards? Can you explain it to where it is simple?

Mr. CARPENTER. On average we make 12 cents a gallon on a gallon of gas—you pay with cash our margin is 12 cents; if you pay with credit and gas is nominally $3 our profit is four cents.

Mr. POE. All right. Let me ask you this question: What is the cost of dealing in cash and with checks versus your cost in dealing with credit cards? That is really my question.

Mr. CARPENTER. Well, cash we receive immediately, obviously, when it trades hands from the customer to ours——

Mr. POE. You don't have more security because of cash, dealing with cash? You don't have issues with checks?

Mr. CARPENTER. No. We have great bank vault systems that are electronically controlled. And we still take a lot of cash. Don't get me wrong. So cash is very easy to take. Checks, I think we pay five cents to process a check. It gets deposited in the bank that day with the——

Mr. POE. So you are saying that the cost is less——

Mr. CARPENTER. Significantly less.

Mr. POE [continuing]. If you are dealing with checks. How much significantly less?

Mr. CARPENTER. Well, I think I said earlier in a statement, you know, to process a check is approximately five cents at our bank, and an electronic form of a check, which is a debit card, depending on the size of the transaction, could cost 20, 25, 30, 35 cents, you know. It depends on the price of the product.

Mr. POE. Let me ask you this: Am I wrong or not? You are dealing in cash the threat of a crime being committed against a convenience store is up because the bad guys know, "Oh, they are holding a bunch of cash back there even though their sign says, 'We don't have change for anything more than a $20 bill.'" Is that true or not?

Mr. CARPENTER. We have been in the business since 1935 in my family and we have had one robbery in 75 years.

Mr. POE. Do you own any stores in Houston? [Laughter.]

All right. Mr. Blum, I have a lot of credit unions, and during this financial mess our credit unions helped the Texas economy because they didn't go out of business, they didn't make bad loans, they did everything, I think, right under this whole financial issue. But I hear from them that they are concerned that the interchange fees—without the interchange fees they could—you know, they would have a—might have to go out of the whole business of the credit card industry if we don't have the interchange fees. Is that a valid fear or not—with the credit unions only?

Mr. BLUM. I don't know. I would tell you that if I didn't have the interchange fees that I have right now—and again, the interchange fees that are significant happen to be on the debit side of the portfolio versus the credit card side of the portfolio—we would have to think real hard about whether or not we could continue to offer that debit card, I mean, to be quite honest.

On the credit card side, the interchange fee—and I just go back to the fraud, I go back to costs and go back to concerns over legislating what is perceived to be as my income, and capping it with no similar cash on my expense. I mean, legislate my fraud. Share it with me. Split it down the matter 50/50. Do all those things.

I mean, if you took away the interchange fee, if you reduced the interchange fee, if you made it more costly in any manner for me to conduct business as a credit union it would impact me, and it would impact me significantly. It would impact the consumer. I mean, there is no profit in a credit union. It is passed on.

I may have to reduce the savings rate. I may have to increase the interest rate.

Mr. POE. Because credit unions provide credit cards for people in many cases that don't—wouldn't get a credit card from someplace else. They go to the credit union.

Mr. BLUM. I can only speak for Chartway, and I will tell you that at times it has proceeded to be very difficult to get a credit card from a credit union. You know, we have fairly high credit standards and we are not afraid to tell a consumer no, that you shouldn't be doing this, you should not be extending yourself. So I think the concept that I couldn't get a credit card anywhere else so I went to a credit union, not necessarily, you know, a true statement based on——

Mr. POE. Well, I didn't mean that because of financial issues. People go to credit unions because that is what is in the neighborhood is a credit union; they belong to an industry that has a credit union. Teachers' credit union, police officers' credit union——

Mr. BLUM. In that matter I would say that people absolutely flock to the credit union. Certainly, we are regulated. We have the usury rate. I mean, our default rate can't be any higher than 18 percent and is significantly lower than the credit card industry. We don't charge balance transfer fees. You know, the number of fees that aren't charged—no, it is a simple tool to access a line of credit. I mean, we use the tool. And when you use that tool there is a cost to using that tool.

And I think Mr. Carpenter even mentioned that he is a small six-store chain. He couldn't afford to set up his own payment card industry. And I think that is what we are really talking about.

We are talking about an infrastructure that is extremely complex that has been set up to facilitate payment and move it around. It comes with it some gives and takes. I have to take fraud. It has to become my responsibility. In that return I get this interchange rate. That is up front.

I don't know—you know, you talk about not being able to determine what I am going to get, I can't tell you what my interchange net after I pay for fraud will be next week, next month, because I don't know when that fraud will appear.

Mr. POE. All right. Thank you very much.

I yield back, Mr. Chairman.

Mr. CONYERS. Judge Hank Johnson?

Mr. JOHNSON. Thank you, Mr. Chairman.

Economists have disagreed about whether the increased use of debit and credit cards actually increases costs for merchants. What I would like to know is, are there any ways where private—or, excuse me—are there any ways that the public could determine or measure the extent to which merchants increase retail prices to account for the cost of accepting the cards? I will ask that question of Mr. Carpenter and then of Mr. Kantor.

Mr. KANTOR. Go ahead, Dave.

Mr. CARPENTER. I think, again, to be clear, we are asking for simply transparency and the ability to negotiate, where today we don't——

Mr. JOHNSON. Well, I know what you are asking for——

Mr. CARPENTER [continuing]. And for the customer to be able to see—I guess I am not sure—you are asking, how is it possible for the customer to see the cost?

Mr. JOHNSON. Yes. And how is it possible for me, as a congressman, to see what your actual costs are for accepting these cards? Or is that proprietary information and we just have to trust you?

Mr. CARPENTER. The point of purchase, when you are purchasing a product right then and there?

Mr. JOHNSON. Yes.

Mr. CARPENTER. I mean, obviously, certainly we could certainly post prices for all 4,000 items inside our store.

Mr. JOHNSON. I mean, but, yes, you can price list, but actually transparency to where we could actually look at your actual costs.

Mr. CARPENTER. If you are asking if we could provide that, yes.

Mr. JOHNSON. But no independent, say, audit——

Mr. CARPENTER. Sure. You can come in and audit—you know, if you sign confidentiality agreements you are welcome to come in and look at our books and see what—is that what you are asking?

Mr. JOHNSON. That is not really a practical way, though, of being able to determine your costs. And I guess if we are looking at costs from the banking institution, if we want to say that they are charging too much for the interchange fee and that needs to be regulated, that we could also use that same logic to impose regulations on, say, retailers to provide on every category of goods sold to give us detailed information. Would that be something that you would be in favor of?

Mr. CARPENTER. We do compete, and we do—it is transparent. Like I said, we have 30 different options every day in our market to buy fuel from different suppliers. You know, as a bank—even if I put the bank hat on, we can't negotiate interchange with the bank with Visa and MasterCard. So, you know, this is simply a—if you look at our costs, if you look at the written testimony, over time the cost for accepting credit and/or debit has risen dramatically, and——

Mr. JOHNSON. I know we can make those conclusions, or we can utter those conclusions, but how can we really determine whether or not this legislation will benefit consumers?

Mr. CARPENTER. Go ahead.

Mr. KANTOR. Congressman, if I could, on your question there, a couple of things that may be instructive here. One is, I referred to the study that Robert Shapiro, Sonecon, put out earlier this year, and what they concluded is that the amount that consumers are paying that has been in fact passed through to them and that is over, above, and beyond the cost and a reasonable return on that cost of processing the transactions is nearly $27 billion every year. So that is them.

The Hispanic Institute did a study they put out in November of last year, and they, in fact, determined that over time not only did they take a look and say there is a regressive wealth transfer from low-income to high-income people, but they found, based on the data they analyzed with the University of Pennsylvania economists, that in fact, when interchange fees were lower that translated into lower consumer prices; when interchange fees were higher that translated into higher consumer prices. That was their finding, the Hispanic Institute——

Mr. JOHNSON. Okay, you are giving me some information from a private entity which I don't know who controls it, but I will say, how can we determine that passage of this legislation will, in fact, benefit consumers? How can we guarantee that?

Mr. KANTOR. Well, the answer, as Mr. Mierzwinski pointed out, is that you have got on the retail side a competitive marketplace that does return those things. As I said, we are happy to put into the record the Department of Energy study on cost pass-through, the Hispanic Institute study showing that interchange itself is passed through, and Robert Shapiro's study showing how it is passed through.

Mr. JOHNSON. I mean, when expenses are passed through we can accept that, but how can we determine that a savings will be passed on?

Mr. KANTOR. Because the Department of Energy looked at precisely that question, and they found that when there were cost savings to businesses those reductions were passed through at 100 percent. That is the Department of Energy, and we are happy to provide that report to you; you can make of it what you will.

But there is a reason, for example, that when gasoline not too long ago was $4 a gallon it went back down to about $2 a gallon; now it is back up again. The reason is, as businesses have lower costs the competition means they have got to reduce their prices to try to attract business. And the opposite is true: If they get higher costs they try not to have to increase prices to keep business, but at some point they need to do that.

Mr. JOHNSON. Thank you.

Mr. Blum, your response?

Mr. BLUM. You know, you are asking how do you guarantee it? I would ask the question now—I think the example we were just given, 12 cents was the profit, but if it is paid with a credit card

I think it dropped to four cents, so there is an eight cents per cash transaction saving that I assume that you pass on to the consumer. I mean, that savings when they pay with cash they buy their gas for eight cents a gallon less. I mean, that is the same—that is, I think, the guarantee that you are asking for.

I am not sure I see it in the market now. If the credit card interchange cost of doing business is so high I see examples—big stores, I will use Walmart as an example—has a proprietary card that, in fact, discounts the consumer at their gasoline pump if they use that card. Surprisingly, though Walmart doesn't extend that discount to the consumer if they come and shop in the store. So they are picking and choosing where they want to push this—you know, use the examples. You can use the gasoline station and the 12 cents a gallon; I am not certain in my mind that explains the $1.69 I paid for a Coke in one of these convenience stores.

But nonetheless, the transparency in it and the cost of it—they discount for cash. I see some gas stations doing it. I can't answer the question as to why all of them aren't doing it. As a consumer I certainly would make the decision whether or not I paid for it with a card.

By paying for a transaction with a card, I might add, that the consumer receives certain protections that they don't get with the cash. They now have the power and strength of Visa or MasterCard or American Express or Discover should there be some service that isn't, you know, as portrayed, there is some sort of problem, there is a dispute with the vendor. They have a larger voice when they pay with Visa and MasterCard.

And I believe that there are a number of consumers that understand that and elect to use that card just for that protection. The cash or the check doesn't offer that.

Mr. KANTOR. Congressman, could I add just one quick thing here? One thing I would say to Mr. Blum's point, we have tried, in many different forms, to have the ability to discount, whether it is for cash, or cheaper cards, or what have you, and this bill is part of that. It would give us the ability to try to negotiate that.

The banks have consistently lobbied against our ability to provide those discounts. So if they are willing to say with us, "We ought to be able to give those discounts," we would be quite pleased.

Frankly, you could make it mandatory. Make it mandatory that every merchant across the country must provide a discount for cheaper cards or for cash. You know what? Throw us into that briar patch because I think the banks will be quite appalled at the idea that consumers would actually see the cost that is being imposed every day.

Mr. JOHNSON. I will tell you, I don't think that anyone wants to get into the business of micromanaging pricing issues, and that is kind of like it has been a—with this legislation.

So I yield back. Thank you, Mr. Chairman.

Mr. CONYERS. Jason Chaffetz, Utah?

Mr. CHAFFETZ. Thank you, Mr. Chair.

Mr. CONYERS. Jason Chaffetz, Utah?

Mr. CHAFFETZ. Just Jason will be fine. Thank you, Mr. Chair.

Mr. Kantor, let me be crystal clear here. Would you support legislation for us mandating, by Federal law, that 100 percent of the discounts—or, the savings and discounts—be passed through to consumers?

Mr. KANTOR. There are a couple of things. We are——

Mr. CHAFFETZ. Yes or no? I mean, you were pretty adamant about saying, "Oh, throw us into that briar patch." Is that your position?

Mr. KANTOR. The briar patch is, require us to provide a discount based on cheaper payment methods. So, for example, if you said we must have a different price Visa versus Discover versus cash or something along those lines, you know what? Consumers could see it; they could react——

Mr. CHAFFETZ. Would you support 100 percent of that discount being passed to the consumers—100 percent? Yes or no? 100 percent——

Mr. KANTOR. Right now——

Mr. CHAFFETZ. One hundred percent, yes or no?

Mr. KANTOR. Can I answer your question?

Mr. CHAFFETZ. Yes or no, yes you can. Yes or no?

Mr. KANTOR. Merchants like Dave Carpenter right now are——

Mr. CHAFFETZ. Okay, we will move on. We will move on. I think it is a very disingenuous thing to say because you do have the ability under current law and current structure.

Mr. Carpenter, what is the discount—if I go to your store right now and I pay cash, what is the discount?

Mr. CARPENTER. There is no discount.

Mr. CHAFFETZ. Why not?

Mr. CARPENTER. First of all, I think we have discussed often about the limitations on being able to give cash discounting. We are not allowed to do cash discounting. There have been fees.

Mr. CHAFFETZ. I am in disagreement with you on that. I do believe you are allowed to give a cash discount. We won't take the five—I only have 5 minutes here so I want to keep going.

Help me understand the difference between 12 cents and four cents. Assuming a gallon of gas is $3, why is there an eight cent differential between the two?

Mr. CARPENTER. Well, the credit card fees on average charge approximately 2 percent interchange plus a slight——

Mr. CHAFFETZ. Two percent on a $3 gallon of gas is six cents.

Mr. CARPENTER. Yes.

Mr. CHAFFETZ. But why is there an eight cent differential?

Mr. CARPENTER. Well, I think I just didn't do the math right on that particular example, but, so, you know, but it is $3.50—it changes every time. So the point being, cash is zero to accept cash, and gas——

Mr. CHAFFETZ. You are talking about your margin, right?

Mr. CARPENTER. Right.

Mr. CHAFFETZ. Between cash——

Mr. CARPENTER. So if the margin was 12 cents—our retail margin was 12 cents——

Mr. CHAFFETZ. Right.

Mr. CARPENTER [continuing]. And you pay with a credit card, six cents of it goes to pay for credit.

Mr. CHAFFETZ. Right.

Mr. CARPENTER. If you pay with cash we keep the 12 cents.

Mr. CHAFFETZ. What about the four cents? You came up with four cents if——

Mr. CARPENTER. I think you are, you know—that example—I didn't use the right math, right, but——

Mr. CHAFFETZ. Okay. But there is clearly——

Mr. CARPENTER. It is the same result, essentially.

Mr. CHAFFETZ. The net here is, though, that there is a differential between credit card and cash——

Mr. CARPENTER. We have to sell half of the gallons we sell to pay for credit.

Mr. CHAFFETZ. What percentage of the transactions do you have right now and is that representative of——

Mr. CARPENTER. Eighty-five percent of our transactions are paid for with credit.

Mr. CHAFFETZ. Okay. So when you actually do get an increase in your margin by accepting a cash transaction you are not passing any of that back to the consumers. You are passing zero percentage of——

Mr. CARPENTER. I think you can go back and look at our history, and our fuel margins aren't based on a percentage of the fuel price, their cents per gallon. If you go back and look at our industry data our industry data stays pretty darn consistent over——

Mr. CHAFFETZ. Well, the credit card transaction fee is based on a percentage.

Mr. CARPENTER. Right.

Mr. CHAFFETZ. And so assuming, based on today's——

Mr. CARPENTER. I would love for either Wallace or our trade association to get together and determine that all gas stations are allowed to charge a margin versus cents per gallon, but that would be antitrust.

Mr. CHAFFETZ. I guess the point I am trying to make is that when you were given the opportunity, when you did have an increase in your margin because your costs were less, you didn't pass that on to the consumer.

Mr. CARPENTER. We didn't have an increase in our margin.

Mr. CHAFFETZ. You do when you accept 15 percent of your transactions——

Mr. CARPENTER. The higher the price of retail fuel the less margin we make.

Mr. CHAFFETZ. But when you are accepting that, you know, well—when you are accepting—because there are a lot of variable costs in there, because if 85 percent of your transactions are still charged at 2 percent you—there is clearly a differential—and I guess the point I am trying to make is what you hear all the time for the convenience stores and what not, is, well, yes, we need the—we will pass that right back to the consumers. I am not buying it because I don't see the examples of that. It is a Phillips Conoco station, correct?

Mr. CARPENTER. Right.

Mr. CHAFFETZ. And do you use Phillips Conoco to do your credit card processing?

Mr. CARPENTER. Yes.

Mr. CHAFFETZ. Okay. In September of 2006, effective in the beginning of 2007, MasterCard announced a cap on the interchange at around the $50 level. In other words, once a customer purchase reached that level there was no further accumulation of the interchange fee. But what I am not seeing is that being passed on to the consumers——

Mr. CARPENTER. We pay interchange on every dollar we sell. There was no cap on interchange fee as far as a dollar sale.

Mr. CHAFFETZ. We are going to have to go back and explore that, because I think that is the case. And I don't think it was passed back onto the consumers. I think this is a very hollow, shallow argument, as Mr. Blum said.

Now, let me ask you about this: Going back to your bank, you said that it is essentially break-even, that it is de minimis. One of the unintended consequences or concerns is that if you are driving down the price or the fee that goes to these small community banks, the larger community banks, the other banks, what is going to be the net result? If you suddenly went to your—I mean, I am kind of surprised that as a director you didn't even know what the costs were—but if you went to them and said—and the guy came back and said, "We are losing $50,000 a month," what would you do with your credit card program? Are you telling me you would keep it just because you are a good guy?

Mr. CARPENTER. Yes, likely. We view it as a service. We just aren't able to——

Mr. CHAFFETZ. But there is value to it. There is value to it.

Mr. CARPENTER. You know, for a small select of our customers we were just not able to compete in that business, as it shows in the bank. Any bank with less than $1 billion in assets just can't——

Mr. CHAFFETZ. But you do participate in it.

Mr. CARPENTER. Right. And we absorb that cost. And in fact, we lose some money. Last 2 years we have lost money in that business, and we consider it because we allow—we give business customers, which are a majority of it, we have their loan for their business, we get their checking accounts, we have 401k, we have investment people, and we consider that a portion of our entire package. And——

Mr. CHAFFETZ. Thank you. I have to cut myself in deference to the Chairman here.

Mr. Chairman, I think one of the unintended consequences of this bill is that you would have fewer players in this industry because the biggest of the big banks can handle this, but if you were to reduce these fees you will see even a good, healthy community bank like this, you start to reduce the amount of money that they are going to be able to collect just to break even, and even lose a little bit of money, the unintended consequence here is you are just going to have fewer players. There is going to be more systemic risk and you are going to have fewer players.

You are going to hurt community banks; you are going to hurt banks all across this country. And I don't think that is the intention——

Mr. CARPENTER. Most banks smaller than us outsource to the big banks anyway because they cannot have their own internal credit card program.

Mr. CHAFFETZ. Thanks, Mr. Chairman.

Mr. CONYERS. Judy Chu?

Ms. CHU. Thank you, Mr. Chair.

Mr. Mierzwinski, let's just say I had three different cards—a card that was a frequent flyer card, a premium card, and card that was not a premium card, just a plain old card. Could I find out what the interchange fees are?

Mr. MIERZWINSKI. If you were a consumer who wanted to be very persistent you could find it probably on some MasterCard site, but I don't think that would help you very much.

Ms. CHU. And why is that?

Mr. MIERZWINSKI. Well, because——

Ms. CHU. Why is it so hidden?

Mr. MIERZWINSKI. Well, I don't know why you would want to know that by finding it that way. I think it would be easier if the merchant was able to tell you that this frequent flyer card is causing the costs of everything to go up, and this plain, classic debit card is the best way for you to pay if you want to keep your overall prices low. And right now the merchants don't have that ability to provide you the information, so right now you have got to go to some Web site of MasterCard, find out that the interchange on the rewards card is 3 percent, the plain debit card is 1.9 percent, and it doesn't do you any good right now.

Ms. CHU. Would there be a positive effect, Mr. Kantor, if you did know?

Mr. KANTOR. Congresswoman, if consumers had some disclosure we do think there would be a very positive effect. Right now these fees are very complex. You can find them on the Visa and MasterCard Web sites, but as a consumer if you go there it is very hard to know which card category your card falls into.

MasterCard's schedule of rates has 263 different categories and it is over 100 pages long. It is very hard to know where your card falls in that.

You also have to know: one, what type of store you are shopping at, because it is different based on that; and you have to know for some places what the volume of business that store does and for others what the security rating they assign that business is. And so that is pretty much impossible for any consumer to know. But it would be very helpful if consumers knew these—what these costs were and that they were able to see, in the form of a discount or otherwise, what impact that had on their transactions.

Ms. CHU. Now, Mr. Mierzwinski, I noticed in your testimony that you talked about different countries. Does every country have interchange fees?

Mr. MIERZWINSKI. Representative, I don't know if every country does but I think that all of them do, and I understand that Mr. Kantor has a chart that the U.S. interchange fees are the highest and have maintained themselves as among the highest by quite a bit. So I think all the countries with cards have fees; in many countries they are much, much lower.

Ms. CHU. And in the countries where there is a lower fee, how are the cards still able to make profit?

Mr. MIERZWINSKI. Well, I think that is the $64 million question that relates to the entire financial system in this country. How do the companies continue to raise the prices, come up with more complex products, and not have anything that is innovative that lowers prices and that creates real competition?

They are making money in Europe; they negotiated much, much lower fees; they accepted lower fees in Europe through negotiations. But they continue to resist lower fees in this country, I think, simply because they can.

Ms. CHU. Well, let's talk about Europe. So, in Europe they have lower interchange fees. It was negotiated. Was this passed down to the consumers?

Mr. MIERZWINSKI. I don't know that there are any studies that have shown that yet, but I would be happy to look and get back to you.

Ms. CHU. Mr. Kantor, do you have—the same comparison with any country?

Mr. KANTOR. Yes. The Reserve Bank of Australia has concluded that their reduction of interchange resulted in a savings of $1.1 billion Australian dollars that was passed through to consumers. That is the statement of the Australian Reserve Bank.

Now, the bankers have pointed to their own privately-funded studies that contradict that, or they have pointed to language where the Reserve Bank said, "It is hard to measure. This is a difficult thing, as there is inflation and other things affecting prices, to figure out exactly what is passed through, what isn't, what other factors are going into pricing." But the Reserve Bank said $1.1 billion in savings passed through.

Ms. CHU. And what were the mechanics that allows for that to be passed on to the consumers, because people are raising questions here whether there would actually be savings to the consumer?

Mr. KANTOR. Again, that is market economics, that when there are lower business costs those businesses compete by reducing prices to try to get more customers. They keep those margins as low as they can.

And I would point out, frankly, the merchant industry in Australia is less competitive and much more concentrated than it is in the United States. In the United States there is a very, very competitive retail marketplace across industries that has kept the profit margins—come high costs, come low costs, whatever the marketplace is doing on other things and other business costs, those margins have remained very, very low in retail. And in fact, I would say in the convenience store industry I represent, over the last 4 years in a row the convenience store industry has paid more in card fees by billions of dollars than they have made in total pretax profits.

Ms. CHU. Thank you.

I see my time is up. I yield back.

Mr. CONYERS. Judge Gohmert?

Mr. GOHMERT. Thank you, Mr. Chairman.

Appreciate the witnesses being here today.

I wonder, Mr. Blum, do any of rest of your organizations get to have any input at all in the negotiations between the financial institutions and Visa or MasterCard?

Mr. KANTOR. No.

Mr. BLUM. No.

Mr. CARPENTER. No.

Mr. GOHMERT. Question with regard to the machines on the gas pumps that read the cards, charge the cards: Who pays for those on the pumps?

Mr. CARPENTER. We do.

Mr. GOHMERT. We being——

Mr. CARPENTER. Retailer.

Mr. GOHMERT. Yes. Okay. Is there any pressure not to have a cash slot in those machines?

Mr. CARPENTER. There are cash acceptors available.

Mr. GOHMERT. I have just never been—well, I am sorry, in Tyler, where we have got no—no telling how many of the stations—there is only one that accepts cash, and that is completely unmanned. But I just don't ever stop at a store that has a place where I could put in cash, otherwise I would.

Mr. CARPENTER. Right.

Mr. GOHMERT. But the convenience—and my friend, Mr. Johnson, over in Georgia, says he has not ever seen one, but I would just to save me from—I am usually in a hurry—sticking the card so I don't have to run into the store, unless I am going in to get a Dr. Pepper. But otherwise I would just as soon, you know, pay cash.

But it is more convenient to use the card, and so I am basically lured into using my card instead of cash. And, of course, one of the advantages, I do get a receipt, and that helps.

But I have listened with interest to the testimony, and I heard a great deal of it back here. I wasn't sitting in my chair, but—I am perplexed on some of these issues. I see the points that everyone is making, and so what I would like to ask is, if you were in charge and could get Congress to do just whatever you want, just in two sentences, what one or two things would you ask us to do immediately—including nothing. And start with Mr. Kantor.

Mr. KANTOR. Well, there are a couple of pieces of legislation—Mr. Conyers has this bill with Mr. Shuster before this Committee which is very important——

Mr. GOHMERT. Okay. That is more than two sentences.

Mr. KANTOR. Okay.

Mr. GOHMERT. I am not wanting to know about bills. I just want to know, these are two—one or two things that are our priorities.

Mr. KANTOR. This legislation, Mr. Welch and Mr. Shuster's legislation that gets rid of some of the rules that are a problem, and doing something about debit fees—those ought to be cleared in the same way that checks are.

Mr. GOHMERT. Okay. Thank you.

Mr. Blum?

Mr. BLUM. You know, just in regards to this bill alone, I think that no action.

Mr. GOHMERT. But I am also asking about anything—not just this bill, but anything.

Mr. BLUM. I happen to have been a strong proponent of the Fair Credit Act that went in last year. I think that ultimately the efforts to protect the consumer——

Mr. GOHMERT. Okay. But that went in place, so we are back to no action, then? Okay.

Mr. Mierzwinski?

Mr. MIERZWINSKI. I agree with what Mr. Kantor said, and also enact a strong consumer financial protection agency.

Mr. GOHMERT. So you want more government. Okay. Thank you.

Mr. CARPENTER. Very simple: transparency and the ability to negotiate on these fees.

Mr. GOHMERT. Transparency——

Mr. CARPENTER. We want to know the complete system, how it works, the——

Mr. GOHMERT. You get to know what goes on with Visa and MasterCard——

Mr. CARPENTER [continuing]. How they set those fees. I mean, it is behind closed doors how they set. But mostly all we are asking for in this bill——

Mr. GOHMERT. Well, it sounds like in one of those things you want more than transparency, is perhaps some input into that process.

Mr. CARPENTER. We want the ability——

Mr. GOHMERT [continuing]. The basis of your agreement?

Mr. CARPENTER. We want the ability to negotiate like we do with all of our other vendors.

Mr. GOHMERT. Okay. All right. Thank you.

And thank you very much, Mr. Chairman.

Mr. CONYERS. Sheila Jackson Lee?

Ms. JACKSON LEE. Mr. Chairman, thank you. I am just trying to refresh my memory of whether or not we have gone this route before, and I hope maybe we will gather the steam and be able to do what is right and do what is just.

I have had the opportunity to hear from a number of different groups, and I think I had the same opportunity a year or 2 ago on the same go around. And I guess while we are in that circle things deteriorate.

So let me ask these questions in the backdrop of a new climate. Goldman Sachs, yesterday, could find nothing wrong with anything that they had done.

Mr. Chairman, I hope we will have an opportunity, maybe, to have a hearing on the actions of Goldman Sachs. I think it would be appropriate for this Committee and I thank you for your leadership on so many of these issues.

I have a year or 2 of having tried to utilize the TARP monies to help bail out entities that were too big to fail, and every time I go home I keep hearing from small businesses and homeowners that they can't—homeowners can't seem to get foreclosures stopped. It is hard-working two-salary members of the family and they can't seem to get any consideration for their foreclosure being—not the foreclosure, but to be—their mortgage to be reformulated.

And then you have small businesses coming and saying, "I thought you gave TARP monies to the bank that I am banking with, and I can't get a loan. I can't get a loan to expand." So we had a different climate about a year or 2 ago, Mr. Chairman, if my memory recollects, in terms of this bill. We just have a sheer pounding of the consumer.

And I am trying to find out what the angst is, and I would like to be balanced as well. And I am going to start with Mr. Kantor, who may have a perspective that is to help the consumer, and if there is a perspective that says that this is literally going to shut the doors of those who want the fees to be maintained I will welcome that exchange as well.

But please be aware, it is difficult to turn away anything that now is going to help consumers, because there seems to be a blind eye or deaf ear without any commentary on those who suffer those ailments in actuality.

But after yesterday's testimony that some of us were able to glimpse it seems an atrocity—it seems to be a full lack of understanding about what we are needing to do to percolate the economy. Part of it is to use credit cards and credit, but part of it is to get people to use it and to get our small businesses and our stores to be open, many of whom have fallen upon hard times.

I just don't understand it. And I am sorry that if I have gotten sidetracked on Goldman Sachs, but I had nightmares from yesterday and I am still seeing a panel sitting here and I am not even in the hearing room—acknowledging nothing.

So, Mr. Kantor, can you tell me how the present discussion that we are now having in the legislation about the interchange fee is going to impact positively on those that you might be speaking about, and maybe you might throw in the economy? And I know you are a lawyer and I know you are here for a particular legislative initiative, but you might share your thoughts, please, sir.

Mr. KANTOR. Sure. Thank you for the question, Congresswoman. This is an important point and I pointed earlier to the Robert Shapiro study on this, and he——

Ms. JACKSON LEE. And as you do that—because the Chairman has been kind—let me just pinpoint to make sure that I get an answer from those who find this to be a difficult hurdle.

And with that, Mr. Blum? Mr. Blum, are you opposed?

All right. So we welcome any others, but let me make sure Mr. Blum is heard.

Yes, Mr. Kantor?

Mr. KANTOR. So, what Mr. Shapiro found is that by dealing with the interchange fee and just the amount that is not justified above the processing and rate of return and is, in fact, passed to consumers now, dealing with this could put almost $27 billion in consumers' pockets to spend, additional stimulus, and would create——

Ms. JACKSON LEE. If the fees did not——

Mr. KANTOR. That is right.

Ms. JACKSON LEE [continuing]. Go up.

Mr. KANTOR. And we would create 242,000 new jobs.

The other thing that we haven't had a chance to talk about today—and I appreciate you asking it for this reason—is Mr. Mierzwinski has pointed to this as his Adam Levitin, the professor at Georgetown, is that for the large banking institutions, they make 60 percent profit margins on these fees.

The large amount of these fees of $48 billion has created an incentive for them, and the incentive is for them to look at the consumer not as a customer to whom they lend who they want to do well so they will pay back the loan, but as a fee-generating machine.

And so the incentive is, generate these fees, find other fees—late fees, over-limit fees, you name it—find more fees that we can pile on the consumer and worry less than they should about the consumer's ability to absorb that and pay the money back. From our perspective it leads to a predatory lending-type cycle, where they want people to use those credit cards even if they can't afford it to keep those fees coming, and don't worry about the longer-term consequences.

Now we are here, and as you point out, Congresswoman, we now see those longer-term consequences; we have seen dramatic rises in the number of people who cannot pay, and that hurts all of us and has been a tremendous problem for all of us. But that is the economic incentive that has been created here.

And Chris Dodd has pointed to this, and others: It is too much to resist, and so many banks now—not the smaller banks and credit unions who you see here today, but the top 10 largest banks who charge more than 80 percent of interchange fees—those are the ones we are concerned about that are creating this dynamic.

Ms. JACKSON LEE. And you think this bill is grounded in a legal premise as well, that it has passed the muster of legal standards, a ritual cannot be considered interfering with a business relationship?

Mr. KANTOR. That is right.

Ms. JACKSON LEE [continuing]. And/or retail or bank?

Mr. KANTOR. That is right, Congresswoman, because right now we don't have a competitive market for these fees. We don't have a free market system. This would allow some market dynamics to come into the system for the first time.

This legislation does not dictate outcomes. It doesn't say fees will be lower; it doesn't say they will be higher. It says there will be a negotiation, and let's see what happens.

And importantly, what Mr. Conyers has done in this bill, which is very helpful, is they have said for the smaller banking institutions you have two forms of protection: You can opt out of these negotiations if you choose. If you are in the negotiations there is a provision that says the agreements cannot disadvantage the smaller banking institutions, and that is important.

It does so for the smaller merchant businesses as well. That is a key protection in the legislation that we are very much in favor of.

Ms. JACKSON LEE. Thank you.

Mr. Blum, let me just say that I am strongly in favor of credit unions and small banks. I represent them and fight for them. Would you just want to comment on this legislation?

Mr. BLUM. Certainly. And thank you.

The problem that I see is, again, the differentiation and the possible differentiation. The opt-out is a wonderful provision but it moves the credit union industry backwards. We have worked very, very hard to establish ourselves as a financial institution of choice, on par with a big bank. And we don't welcome any kind of differentiation in that regard that might disadvantage us by having us, you know, some card that might be perceived by the merchant or the consumer to be, you know, less friendly to a merchant, carved out or not.

I think some of the other points that I make, that, you know, I am in basic disagreement with is, the GAO study says that there will be significant compliance costs. I am concerned that these significant compliance costs are going to be passed across the entire network and are going to be impacted upon me.

Furthermore, just the basic premise that everybody is perceiving the interchange to be a profit. I think my written testimony has said it is not. There is profit in it; I acknowledge that.

However, if you want to legislate, if you will, the income side and somehow reduce that, then I believe that you must also legislate the corresponding cost side. You have to legislate that the fraud has to be reduced and you have to enforce that legislation. You have to legislate that my processing costs and my payroll costs, that my card production costs—all the costs associated with delivering that program need to be able to move in conjunction with whatever legislation or restriction that is placed upon it.

I don't see that provision. So ultimately, while being carved out, while sitting here as a credit union, I am concerned for the impact of this bill——

Ms. JACKSON LEE. Well, I think you heard Mr. Kantor say that the bill does not dictate outcomes, but certainly you have made some points that can be looked at. I think the carve-out is a gift, but as we look at how the impact is I think the comment and testimony that you have today—I would characterize it not as an opponent as much as it is someone who wants to be sure that they are still standing and still made whole in the scheme of structure.

I mean, your credit union—or the premise of credit unions is consumer-friendly, and that is what I hear from all of your customers—and small banks as well. And unless I hear something more different, these fees are not consumer-friendly, and this legislation is not an attempt to make good guys and bad guys, but it is an attempt to even out the playing field. There are a lot of small businesses that are involved in this.

And I am going to end on this: I just want to—Mr. Kantor, you said $27 billion to consumers and you said jobs—what was that number?

Mr. KANTOR. 242,000.

Ms. JACKSON LEE. 242,000 to save or create?

Mr. KANTOR. Create.

Ms. JACKSON LEE. Okay. I need 242,000 jobs. Anyone here just want to comment quickly—retail—quickly, please?

Mr. MIERZWINSKI. Congresswoman, I would just say that I concur with Mr. Kantor. I look at this bill, though, the same way you do, as it is forcing the banks to the table, forcing them to negotiate to make things better. But all the points you made—the banks are not negotiating on putting people back into their homes; they are actively sabotaging the President's work and the Congress' work on trying to help homeowners save their homes. Goldman Sachs is actively trying to change the historical record to preserve their casino economy that hurts the real economy.

And on the Senate side, Mr. Delahunt, as you know, the Senate is under tremendous pressure to eviscerate your proposal for a consumer financial protection agency. We hope they reject it.

Mr. DELAHUNT. The proposal to eviscerate it.

Mr. CARPENTER. Quickly, just to point out again, we get all over the place here, but again, all we are asking for is to be able to sit down at the table and negotiate these fees. If Walmart and Target controlled 80 percent of the retail dollars in the country would you not be concerned? MasterCard and Visa control 80 percent of credit cards in this country. The top eight banks in the country control 80 percent of the credit cards, you know.

So all we are asking is for the free market to work. Today, I am a customer of theirs. I have no ability to negotiate. None. That is all we are asking for.

Ms. JACKSON LEE. You want the squeaking to be heard?

Mr. CARPENTER. Yes.

Ms. JACKSON LEE. You are a little squeak, but you want that squeak to be heard.

Mr. CARPENTER. I don't know if we will be able to lower them; we just want to try.

Ms. JACKSON LEE. Mr. Chairman, let me thank you for indulging and moving the hearing on this important—very important issue. And I hope that we will see Goldman Sachs and relevant parties before this Judiciary Committee. I yield back.

Mr. CONYERS. Bill Delahunt?

Mr. DELAHUNT. Thank you, Mr. Chairman.

I just dropped by to listen; I didn't really intend to ask any questions. But I heard the figure 60 percent profit.

Mr. KANTOR. That is correct, Congressman.

Mr. DELAHUNT. Does anyone on the panel disagree with that number?

Mr. BLUM. Yes.

Mr. DELAHUNT. What number would you give to me?

Mr. BLUM. You know, the 60 percent profit—this interchange—I would argue——

Mr. DELAHUNT. Just give me a number. Give me a number if you know it. I am not trying to——

Mr. BLUM. No. I don't know the specific number—nowhere near 60 percent.

Mr. DELAHUNT. Give me a range.

Mr. BLUM. I believe the net of expenses last year was somewhere in the neighborhood of 8 or 9 percent of the interchange was retained and placed into the bottom line. I think Mr. Carpenter testified that none in his bank went to the bottom line.

Mr. DELAHUNT. Eight or 9 percent. Now, that is a real disparity.

Mr. KANTOR. Congressman, if I might——

Mr. DELAHUNT. Sure.

Mr. KANTOR [continuing]. The difference here is, as I said, there are 10 banks in the country, and most of them you know right off the top of your head—Bank of America, Citibank, JPMorgan Chase—just 10 banks get more than 80 percent of all this money. Now, the small institutions—the credit unions, the community banks like Mr. Carpenter have—they are not getting much of this money, and they can't spread out the costs of running—in the same way.

So they may make only 8 or 9 percent; I don't doubt that for a moment. But industry-wide, that means their larger competitors are making even more than 60 percent, because that is—we are happy to give you the data. It is from Cards and Payments. The data is out there. People can make of it what they want——

Mr. DELAHUNT. That is a very interesting point.

And I would hope, Mr. Chairman, that we could have staff do some research for us to corroborate those numbers, because it does—it just simply makes sense that the smaller the institution, the cost presumably somewhat fixed, and the profit margins, rather than 60 percent, might be 65 percent or 70 percent for the larger banks. Interesting.

Mr. CARPENTER. Congressman, if I could just add to that, as a small bank, I mean, Mr. Kantor is correct in the fact that—and I empathize with Mr. Blum. I mean, the problem is—the argument that has been made that this is going to hurt if not destroy small banks and credit unions—Congresswoman, I think, Wasserman Schultz, is her name, who I believe is also in the banking business—the point is, it is an insignificant, nonmaterial part of our revenue and income.

I am not here to say, you know, that, I mean, credit cards are bad and we don't want to have credit cards in our business. What I am here to tell you, that there is a certain hurdle-rate you have to get over to be able to have a credit card department. Small banks can't do that.

He mentioned he has 11 people. I mean, for a bank to have enough staff and to oversee an actual credit card department you have to be pretty big. And so only the large banks are able to do this. They mass market; they sponsor, you know, all kinds of events and shows; you get direct mail; you see, you know, TV ads. Small banks can't do that.

Mr. DELAHUNT. Mr. Chairman, I would hope that we—that you would schedule a markup, and obviously there would be, I am sure, amendments that will be proffered. But, you know, I think there is—we should have a sense of urgency, and I think that a markup, a vote, and moving legislation to the floor in the few remaining months of the legislative calendar is important. And I yield back.

Mr. CONYERS. Steve King?

Mr. KING. Thank you, Mr. Chairman. I appreciate the opportunity to do a little follow up and the clean up here.

One I would ask the witnesses to do, if you could, after the hearing, to present the list of the eight to 10 banks that control 80 percent of the market. It would be helpful to me to understand who they are in that fashion.

I wanted to go back and clarify the testimony of Mr. Carpenter that I think was declarified by the gentleman from Utah, and that would be that roughly the 2 percent interchange fee—if you do that on $3—three gallons of gas at a 12-cent margin that becomes six-cents cost, but if it is 2 percent on $4 gas that is the eight-cent cost, which I think is what Mr. Carpenter was referring to. And you have referred in your testimony earlier in the day, before Mr.

Chaffetz was here, talked about $4 gas. So I think that is where that got crossed.

Let's just go up to $5 gas, 10 cents; $6 gas, 12 cents. That would be to break even, then, with the 12-cent margin per gallon. Correct, Mr. Carpenter?

Mr. CARPENTER. It is correct.

Mr. KING. On $7 gas you would lose two cents a gallon in the——

Mr. CARPENTER. Our margin, unfortunately, does not go up with the price of gas; it gets less.

Mr. KING. You have a per-gallon margin that has this track historically back through decades.

Mr. CARPENTER. I mean, unfortunately, I mean—when they ask will it pass on to the consumer, unfortunately for, I guess, myself and my industry, we are not very good at holding on to the money. It is so competitive that even if I choose that I would like to hold on to some of it, if the guy across the street doesn't, down it goes.

Mr. KING. And we recognize here implicitly that gas is a lost leader, but it is still, that is the way the market works in the retail gas market.

Also, I wanted to explore this thought that when I go in and use my credit card I get free credit for that month, and I get frequent flyer miles, I get—well, maybe I could get some free luggage, or trip, or whatever out of all of that. The credit card user that pays their bill every month and ends up with a different effective retail price than the person that is paying cash or paying by check or paying by their debit card, and we haven't explored that in this discussion.

I noticed—and I thought of this when Mr. Johnson was asking his questions—his concern about the consumer. I have an unfair advantage if I pay my bill every month, and that can't be reflected in your pricing either. And I think that needs to be brought into the discussion as we either do or do not move forward with this piece of legislation that we are discussing here today. And I make the point—I don't know that it needs to be explored; it just needs to be made.

And then I wanted to come back to a statement by Ms. Wasserman Schultz with regard to the witness, Mr. Carpenter, her statement that conflicts are popping up here everywhere with regard to your retail outlets for convenience stores and your investment in the Liberty Bank ownership group and on the board of directors. And I think she said flat-out that the bank is owned by 400 retail outlets. It seems to me that you compete with those 400 retail outlets out there to sell gas and convenience items.

But I want to make the point that there is no conflict of interest when you bring an expert witness before this Committee that has expertise in more than one subject. That is the benefit of Mr. Carpenter, here, testifying today. He can speak with authority, here is how it affects the bank with roughly $1 billion in deposits, and also with authority on how it affects the convenience store outlook. So I don't think it is a conflict of interest at all. I think it gives us a double benefit of hearing the testimony.

And I appreciate the viewpoints on both sides of this, and I have heard very strongly from them—from our smaller banks that we have—but I haven't heard very much from the big banks. They haven't knocked on my door, and that is why I am interested in the names of those banks.

But I appreciate the Chairman bringing this hearing today. It has been one of the more interesting ones that I have sat in on, and the focus of the people in the audience also would testify to that.

And you witnesses have been very attentive, and the Members have participated well. And so I just thank the Chairman and I yield back the balance of my time.

Mr. CONYERS. Maxine Waters?

Ms. WATERS. Thank you very much, Mr. Chairman. First, let me apologize for not being here at the beginning of the Committee. I had to Chair my Subcommittee on Housing and Community Opportunity over in Financial Services, but I would just like to take up my statement.

And thank you for organizing this hearing to discuss interchange fees. While we have yet to reach a consensus on this issue, I am concerned most with the impact interchange fees have on working families and American consumers.

The Visa and MasterCard competition in the card business has become more about pleasing the banks that actually issue the cards rather than the consumers who use them. Visa and MasterCard set interchange fees that merchants must pay the cardholder's bank.

Accordingly, higher fees mean higher profits for banks even if it means that merchants shift those costs to the consumers. Today, as debit cards have become more commonly used, MasterCard and other rivals have raised fees on certain debit card transactions in order to entice banks.

Therefore, I am increasingly alarmed by reports that suggest banks may now be coercing their customers into signing for debit card purchases rather than entering a PIN code. Despite the fact that in any debit card purchase the money will be withdrawn from an individual's checking account, the banks are now encouraging customers to sign their debit purchases so they can charge the merchants higher interchange fees.

Just last week in an article in The American Banker it was reported that JPMorgan Chase is advising its customers to use their signatures rather than their PIN code when making debit card purchases, although experts say PIN debit transactions are more secure than signature debit purchases.

In a recent mailing issuing Chase banded debit cards to former Washington Mutual customers, the banking company strongly suggested the clients always select credit when paying with their debit card. While JPMorgan assured its customers that the cards were not credit cards and the money still comes from their checking accounts, the company insisted that cardholders choose the credit option during transactions so they won't have to enter their PIN in public.

In its mailings JPMorgan implied that it is safer to use a signature when paying with a debit card, but experts say this is not true. Entering a PIN is actually more secure. But in this instance, JPMorgan discouraged the practice because it does not generate as much revenue for the bank.

Now that many consumers are shying away from credit cards the banks are doing everything they can to reap fees from debit card purchases. While none of this may initially seem to implicate the American public, as credit card companies charge merchants more the accept their cards and process transactions, the merchants, in turn, pass those costs off to customers by increasing the cost of their products.

The Food Marketing Institute is also calling for interchange fee reform because of the impact the fees have had on the supermarket industry. On April 16th—number of debit network, run by Visa, increased its swipe fees by 30 percent for PIN debit purchases. These fees impact small, independent businesses and grocers because they pay some of the highest rates and have no choice about whether or not to accept debit cards to maintain being competitive.

Some merchants even argue that there should be no interchange fees on debit purchases because the money comes directly out of the checking account and does not include the risk and loss associated with credit cards. In any event, merchants say they inevitably pass on that cost to customers—to the consumers. The National Retail Federation says the interchange fees cost households an average of $427 in 2008.

Let me just close by acknowledging Doug Kantor, a partner at the law firm of Steptoe & Johnson, in Washington, D.C. He grew up in my district in Los Angeles. Early in his career Doug served in the U.S. Department of Housing and Urban Development working to improve affordable housing and bring opportunities to places in need.

His father was my close friend—still is—Mickey Kantor. We have been friends and worked closely for many years, and you would recognize the name because he served in the Clinton administration.

Thank you for your patience, Mr. Chairman. I do appreciate it. I yield back.

Mr. CONYERS. Thank you for your contribution.

We will have 5 additional days to submit any questions or to receive any other materials, and to introduce into the record a Food Marketing Institute article on the Credit Card Act, dated April 28, 2010.

[The information referred to follows:]

FOOD MARKETING INSTITUTE

Statement by the Food Marketing Institute on H.R. 2695, the Credit Card Fair Fee Act

April 28, 2010

Food Marketing Institute (FMI) conducts programs in public affairs, food safety, research, education and industry relations on behalf of its 1,500 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores and 14,000 pharmacies. Their combined annual sales volume of $680 billion represents three-quarters of all retail food store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from more than 50 countries. FMI's associate members include the supplier partners of its retail and wholesale members.

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On behalf of our nation's neighborhood grocers, the Food Marketing Institute strongly supports H.R. 2695, the Credit Card Fair Fee Act. We commend Judiciary Committee Chairman John Conyers (D-MI) and Congressman Bill Shuster (R-PA) for introducing this important legislation to provide merchants of all sizes the opportunity to negotiate rates and terms of card acceptance with Visa and MasterCard and the banks that issue their cards. The Credit Card Fair Fee Act would also increase transparency in the interchange fee system by ensuring any fee negotiations that result from passage of the bill are made public.

Visa and MasterCard control 85% of the consumer credit card market and refuse to negotiate interchange rates with retailers of all sizes.[1] In a competitive market, Visa and MasterCard should be competing for merchant business, but they get away with this take-it-or leave-it behavior because of their strong market power. Not accepting Visa or MasterCard is no longer an option in today's society where cards have replaced cash as the dominant currency in many communities. Debit cards, in particular, are essentially a plastic check or an access device going directly to a customer's checking account.

The latest fee increase on debit cards is just further evidence that there is a complete lack of competition in the setting of interchange fees. Visa Interlink, Visa's Personal Identification Number (PIN) network, raised fees again just this month. The fee increases on supermarket transactions are particularly egregious and unjustifiable. A transaction that used to cost a 25 cent flat fee in interchange could now cost 35 cents. Additionally, the fee structure has changed to a percentage of the sale (inclusive of cash back) + a flat fee away from just a flat fee even though there is no credit risk and extremely limited fraud on PIN debit transactions.[2]

The average supermarket industry profit margin is one to two percent, and the latest Visa PIN debit increases will mean a 30% increase in the cost of accepting debit cards. For one of our member companies, that translates to over half a million dollars on just over 20 stores. On small ticket items of less than $2.00 purchased with a debit card, in most instances, the merchant would be better off to give the item away to the customer rather than accept the fees imposed on a debit transaction. On average margins of 1-2% there is no way we can completely absorb that type of excessive increase so we are faced with the option of either increasing prices or cutting back the workforce – neither of which is an attractive option in the current economy, especially when the fees are going to pad the profits of Visa, MasterCard, and Wall Street banks.

The debit fee increases do not stop with Visa. Networks raise rates to get banks to issue their cards even though higher fees harm both merchants and consumers. This type of backwards competition has led to increases on traditionally lower cost debit card networks as they try to compete with Visa and MasterCard pricing in order to get banks to continue to issue cards that run on their network. One example is the PULSE network, which is offering an additional 5 cents in interchange to the bank if the card **only** carries

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[1] The Nilson Report. Issue 933, September 2009.

[2] Pulse 2008 ATM Study. Issuers surveyed lost1.09 basis points (0.0109%) through PIN debit transactions for every dollar spent.
https://www.pulsenetwork.com/public/upload/storage/file80/file/News_Release-2008_Debit_Issuer_Study.pdf

the technology to route a transaction on that specific network. This is anticompetitive and will make costs continue to rise.

In general, interchange fees have tripled over the past decade and are outpacing both healthcare and energy costs for many of our members. The banks and card companies are collecting roughly 2% in interchange swipe fees from our members on each credit card transaction in their stores. These fees not only hurt Main Street businesses, but our customers as well. Our members are doing everything they can to keep prices as low as possible for their customers, especially during these tough economic times, but they simply cannot absorb the full cost increase of excessive interchange swipe fees.

When grocers decide to accept Visa and MasterCard in their stores, they must sign a merchant contract agreement. This agreement is unlike any other contract in the business world in that it can change at any time without any direct notice by the card companies. Included in the hundreds of pages of Visa and MasterCard network rules are prohibitions that tell merchants how they must run their business. One rule they impose is that merchants cannot set a minimum purchase amount for a credit or debit card transaction in their stores. One assessment of the latest Visa PIN debit fee increases shows that grocers will actually lose money on sales of less than $2; yet, our industry is powerless to do anything to mitigate the loss.

The Visa and MasterCard contract rules are also harmful to our customers; although, they do not know it. The Visa and MasterCard rules keep interchange fees entirely hidden from consumers, and leave merchants with no other choice but to include interchange fee costs in the price of all goods and services. As a result, everyone pays for interchange fees regardless of whether they pay with cash, check, credit or debit so our unbanked customers pay the highest rate and gain the least (no miles or rewards points) under the current interchange fee system.

Credit and debit cards provide a convenience for grocers and our customers; we just want a fair and transparent system in which we can negotiate the rates and terms of card acceptance with Visa and MasterCard. We strongly believe the Credit Card Fair Fee Act, H.R. 2695, will level the playing field for Main Street merchants with Visa, MasterCard, and Wall Street banks by giving merchants a seat at the table to negotiate rates and terms of card acceptance for the first time. We would again like to thank Chairman Conyers (D-MI) for holding this important hearing to shed some light on the anticompetitive practices employed by the major card networks and big banks.

Mr. CONYERS. We thank the witnesses. The hearing has been important since we have gone maybe a couple of years since our last one, and I appreciate the very important exchange and the number of people that joined us to hear and observe the hearing.

Thank you all, and the Committee is adjourned.

[Whereupon, at 12:53 p.m., the Committee was adjourned.]

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